MONEY, BANKING AND EXCHANGE IN INDIA

BY

H. STANLEY JEVONS,

Professor of Economics in the University of Allahabad

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PREFACE

Although this book was written with the object of explaining the intricacies of Indian Currency and Exchange in language as simple as possible for the enlightenment of the general public, it may, I hope, prove of some use also to college students beginning their courses in economics. It is a matter for gratification that the Government of India has kindly undertaken to offer it to the public at a price which would hardly have been possible through private agency. It should be clearly understood that the opinions expressed are entirely my own, and that publication by the Government Press does not imply that the matter contained in the book has any official status.

Several chapters were written in Simla during the summer of 1920, and the remainder during the later months of the same year in Allahabad. Fundamental changes were being made in the currency system as I wrote ; and the copy had left my hands for the press before the amalgamation of the Presidency Banks took effect on the 27th January, 1921. These facts must be my excuse for the inadequate treatment of the Imperial Bank, and the relative prominence given to the events of 1920. I regret the delays in proof-reading and in printing which have kept the volume unduly from the public.

To the Hon'ble Sir Malcolm Hailey and officers of the Finance Department I am indebted for much

information and assistance, which has greatly lightened my task, especially in the collection of statistics and illustrative material. I should like also to acknowledge the assistance given me by Mr. D. S. Dubey, M.A., Lecturer on Economics at the Ewing Christian College, and lately Scholar in Economics in the University of Allahabad.

The reader who wishes to follow the subject to a more advanced standard may with advantage refer to the books and Government publications, of which a list appears in Appendix V.

H. S. JEVONS.

ALLAHABAD,
25th November, 1921.

POSTSCRIPT.

I have taken the opportunity offered by a final proof to add a few words about the condition of exchange in 1921 and 1922.

H. S. JEVONS.

ALLAHABAD,
31st May, 1922.

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INDIAN MONEY AND WEIGHTS.

For large sums of money the Indian system of numbers is used :—

1 lac (*lakh*) = 100,000; written 1,00,000.
1 crore (*kror*) = 10,000,000; written 1,00,00,000.
1 crore = 100 lakhs.

Currency Units.

12 pies = 1 anna.
16 annas = 1 rupee.

The pie, one-twelfth of an anna, should be distinguished from the "pice" which is 3 pies or one-fourth of an anna. The pice is a current copper coin, but is not money of account.

Weights.

5 tolas = 1 chattack.
16 chattacks = 1 seer.
40 seers = 1 maund.

1 tola weighs 180 grains (English), and 1 maund weighs $82\frac{2}{7}$ lbs. The seer is equal to 2·0572 lbs., or just under 2 lbs. 1 oz.

MONEY, BANKING AND EXCHANGE IN INDIA

CHAPTER I

THE ORIGIN OF MONEY

Money is something we are all familiar with, because every day we handle it in all the common business of life. We are paid for our work in money, or we sell the produce of our fields for money. We go to the bazar and pay out rupees, annas and pice to buy the things we require. We are so familiar with money that we think that we know all about it ; but there we are wrong. Many strange things were brought about by the recent great war ; and the disturbances in the money used by the people in all countries of the world are one of its most puzzling results. The war has shown that, whilst we know very well what a pice or a rupee is, most of us do not know what will happen if the quantity of money in the whole country changes, and we do not know what it is that causes the prices of goods to change ; so that whilst a rupee would buy 12 seers of jowar before the war, or 8 seers of gur, it will now buy only 7 seers of jowar or 5 of gur, or less.

When we come to think about money in the mass, that is to say, all the money used by all the people in India, we find that it is far from simple to understand. Government has made itself responsible for coining all the money wanted in the country, because thereby it confers a great benefit on the people. At certain times during the war much difficulty was experienced in providing sufficient coins of different kinds to meet the demand of the people, and it was necessary, therefore, to study very carefully the question of the nature of money and to discover the reasons for changes of prices which seemed to take place without anybody doing anything to make them change, or knowing why they changed.

This book has been written to explain what money is, why Government makes the money for the whole country, and why it has been obliged to make certain changes as the result of the war. The later chapters will answer the question why prices have risen.

Money is needed in order to facilitate the exchange of goods. We always want to give away things of which we have plenty in order to obtain other things of which we are in need. If we do not possess goods which we are willing to part with, then we work for some employer and obtain in exchange the food and other necessary things of life. In former days in some parts of India there was no such thing as money. Exchanges were generally made in terms of grain, and a man's

wages could be paid only in grain, just as they are still so paid in many villages at the present day. But it was very inconvenient to make all purchases in grain. If a man wanted to buy a cow, he had to find a man who had a cow, and who wanted much grain ; and he had to measure out to him some hundreds of seers of grain in payment for the cow. There being no money, a rich man was one who had many cattle, or great stores of grain. However, nobody wanted to keep great stores of grain, more than he and his family could possibly eat ; and so men exchanged grain for other things which were useful or beautiful, such as brass and iron, or silver and gold. It became the business of some men to take the ores of these metals out of the ground, and of other men to obtain the metals from them by fire ; and in exchange for these metals the workers received payment in grain, on which they lived.

Everybody likes to have iron and brass because they are useful, and gold and silver because they are beautiful. If a bania, for example, wanted to buy salt from a distant place to sell in his village, he could not send grain a long distance, perhaps two or three hundred *kos*, because it would cost too much to carry grain so far. He would therefore exchange some grain with somebody who had silver or gold, and he would send that silver or gold all that long distance to give it in exchange for salt to the people who make salt. Those people accepted the gold and silver gladly because they

could always find somebody to give them grain in exchange for it. There were no coins, of course, in those days, and silver was either in lumps or bars or was made into jewellery. The gold also was either in little bars or ornaments, or was merely in the form of dust tied up in little bags—just as it was obtained from the river bed by washing the sand. It was difficult to measure accurately a quantity of gold or silver in these forms. The man who was sending silver to buy things had to weigh it out carefully in scales, and the person who was receiving it also had to weigh it. Not only was this very troublesome, but disputes constantly arose as to the true weight of the gold or silver. In order to save people time and trouble, and particularly so as to prevent disputes, it became the custom a long time ago for the king or ruler of the country to have gold and silver cast into the form of small bars which were then stamped with the king's special seal. These bars being always the same weight could be counted out in order to make up the quantity agreed upon for the purchase of the goods. Ill-disposed persons used to cheat by rubbing some of the metal from the bars; and others made imitation bars of metal of inferior fineness and imitated the king's seal. It became necessary to regard these as very serious offenders, and in many countries they were punished by death.

The king found it very troublesome to enforce the laws to prevent people from reducing the weight of the bars of gold and silver in one way

or another, because they could easily do so without damaging the impression of the king's seal ; and it was through the effort to prevent fraudulent clipping and rubbing of the bars that coins were invented.

The first idea was to make the gold and silver in square flat plates instead of bars, and the seal was made square and large enough to fit over the whole of one side of the plate of metal. Many of the Moghal coins were square ; and the Gorakhpuri pice, which are still in use in many villages of the United Provinces, are a relic of this kind of primitive coin. Square coins are not convenient, however, and they tend to wear away at the corners, so the next idea was to make them round, and a round seal of the same size was impressed all over one side. This left the other side without any impression, so that evil-disposed persons could still reduce the weight by rubbing. Hence merchants still found it necessary to weigh the coins lest they should be defrauded. Hence arose the practice of having a design stamped upon both sides of the coin. For many centuries these were the best coins that were put into circulation ; but it was still possible to make a little profit by rubbing gold or silver off the edges of the coins, and this led to the practice of protecting the edge of the coin by what is called " milling."

If you look at a rupee you will see that on one side is a design with the head of the King-Emperor, on the other side is a design and the words " ONE

RUPEE" in English and Urdu, whilst the edge is roughened with straight lines drawn across it, so that if any of the metal were to be rubbed or cut off, the smooth surface would be easily seen. The rupee when it is coined in the mint is made so that its weight is exactly one tola ; and we know that if the design on the front or back, or the milling on the edge, has been rubbed away, it must weigh less than one tola. So long as the original design can be seen, the weight has not been much reduced, however, and for all practical purposes it is still a good rupee.

CHAPTER II

COINS AND CURRENCY SYSTEMS

In the last chapter we saw that coins were made for the convenience of having the precious metals divided into pieces of fixed weight. They were stamped with a design in order to prevent fraudulent reduction of weight, such as took place when bars or ingots of metal were in circulation. The very great convenience of coined money has led to its universal adoption in all countries. Coins are usually round and flat like the rupee or the pice ; but they have been made of other shapes, such as square and oval. For many centuries past coins have been made of three metals—gold, silver and copper ; but the copper is sometimes used in the form of the mixtures bronze or brass. In recent times nickel has come to be largely used in many countries in place of bronze for coins of small value.

In every civilised country in modern times a number of different coins of different values are in circulation together. These have certain relations to one another which are fixed by law ; and these coins in their relationship as established by Government are spoken of as the " currency system " of a country. The coins composing a currency system usually consist of three or four metals—gold, silver, nickel and copper or bronze.

We must now understand two words indicating the legal relations of coins, namely, *standard* and token money. A coin is said to be *standard money* when it is freely coined by Government in unlimited quantities as required. The factory in which coins are made is called a "mint." Government may either coin the bullion which it purchases by giving coined money in exchange, or it may allow its mints to be open for the making of the standard coin, either of gold or silver, from bullion brought to the mint by private persons. A small charge is usually made for assaying the metal before accepting it, and for coining. The essential part about standard money is that Government undertakes to coin it in unlimited quantities if bullion is brought for that purpose to the mint. The standard coin is simply a small round piece of bullion made always of exactly the same weight, and certified both as to its weight and fineness by the impression upon all parts of it being sharp and clear. Standard coins cannot therefore differ in price from bullion of the same metal excepting only by the cost of coinage. Small jewellers and others who cannot purchase bullion in the market find the melting up of standard coins the easiest way of meeting their requirements.

In nearly all countries of the world the standard coins consist of gold, and these countries are said, therefore, to have the gold standard. Unfortunately most countries have adopted standard coins of differing weight and fineness. The

English sovereign weighs 123.274 grains, and consists of gold eleven-twelfths fine, so that the weight of pure gold which it contains is 113.0016 grains. Since there are 480 grains in one ounce Troy, the unit in which precious metals are bought and sold in England, we find that there are 3.894 sovereigns minted from one ounce of standard gold ; and this gives what is called the "mint price" of gold, which, stated in pounds, shillings and pence, is £3 17*s.* 10½*d.* When we compare the standard coins of different countries we do so on the basis of what is called the "mint par" or "parity," which simply means the number of standard coins of one country which is equivalent in weight of pure gold to the standard coin of another country. Thus the weight of a franc in France is 4.4804 grains: and this divided into 113.0016 grains gives 25.2215 as the number of francs which are equal to one sovereign. Similarly the gold dollar of the United States contains 23.22 grains of pure gold, and the mint par, or "parity of exchange," is $4.8667 equal £1.

Token money, on the other hand, circulates only by force of law and custom ; and it differs from standard money in two essential features. In the first place it is made so light in weight that its intrinsic value as bullion is much less than the value for which the law says it shall be accepted. The token coin in fact merely represents a certain fractional part of the standard coin, one-quarter, one-eighth, or perhaps one-twentieth part, so that the

actual quantity of metal it contains does not matter. The second essential feature of token money is that the quantity coined and issued must be strictly limited to the requirements of the public. A certain quantity of small change is wanted everywhere in town or in country. If there is too little small money in circulation, people find difficulty in getting change and buying small quantities of things for everyday use, and merchants in the bazar make a charge for changing the larger coins. On the other hand, if there is too much small money put into circulation, people have more of it than they want; they find it troublesome to carry about and are eager to pass it on to others. Consequently it may fall to a discount, as happened a few years ago in southern China when pieces representing the tenth of a dollar (the standard coin) were issued in such vast quantity that people had too many of them and they became in fact worth much less than the tenth part of a dollar. It is obvious therefore that Government must limit the quantity of the small money which it issues.

The currency laws in each country define the coins which shall be legal tender. Money is said to be *legal tender* according to law when a person is bound to accept it in satisfaction of a debt if offered to him. Thus in India the silver rupee has always been legal tender to any amount. The English sovereign was made legal tender in India in 1893, but the five-dollar gold piece of the United

States is not legal tender, nor is the "halli sicca rupee" of Hyderabad State. The subsidiary coins are *limited legal tender*, that is to say, they may be tendered up to a certain sum only. If a debt is above that amount, the creditor can refuse to accept more than the limit in the settlement of any one debt.

It was explained above that a standard coin is really a small piece of bullion, the weight and fineness of which has been certified by Government. Coins in their circulation pass constantly from hand to hand; they are thrown into boxes and shaken together in bags in the course of being carried from place to place. In this way coins suffer from wear, that is to say, a small amount of the metal is rubbed off the surface and disappears as dust. When coins are much worn, the impression is indistinct on both sides and the edge is rounded. At the same time the weight of the coin is reduced. The natural wear of coins in circulation cannot be prevented, but fraudulent reduction of weight, which is sometimes practised, is punishable by law. Now that coins are produced with a design perfectly executed, it is easy to detect if some of the metal has been filed or rubbed off, but in former times it was not so easy to detect this means of defrauding the public. A small amount of gold and silver was rubbed off each coin, and these were then passed on into circulation, their value being the same as before in making payments to the public for purchasing goods.

Now, the advantage of coins is that the trouble of weighing gold or silver is avoided and payments are made by the simple counting out of coins. Money circulates therefore by "tale," or number of coins, everybody accepting the coin as of full weight. If coins in circulation become much reduced in weight by wear or by fraudulent practices, there comes into operation what is known as Gresham's Law. This is a statement of the generally observed fact that full weight and light weight standard money of the same denomination cannot circulate together. Although the public may treat full weight and light weight coins as being of the same value, and generally must do so, there are men whose profession it is to deal in money and in gold and silver, to whom full and light weight coins are very different. A few men belonging to the class of shroffs, banias, goldsmiths and silversmiths, find that they can derive a profit by abstracting the full weight coins from circulation and passing on the light weight coins. Remembering that we are considering standard coins only, we see that it is only the full weight coins which are fully worth their bullion value : the others are in a very slight degree token coins. Consequently, the full weight coins are selected and melted up into bullion, or are exported to foreign countries, where of course they are dealt with by weight and treated as bullion. Obviously, if rupees were still standard coins in India, a man importing goods from China would select 10,000 full weight rupees rather than 10,000

light weight rupees, because he would lose 2 or 3 per cent if he sent light weight coin to China.

Exactly the same consideration holds if standard coins are put into circulation, of which some contain less pure metal than others. Suppose that some standard coins were issued of which 15 annas was pure silver, whilst other coins of the same total weight and the same nominal value contained only 14 annas pure silver. Obviously, it is the coins containing 15 annas silver which would be melted up and exported, and the metallic currency would eventually consist almost entirely of the less valuable metal.

We can thus state Gresham's Law in general terms, that "bad money always drives out good money." It follows also that good money cannot drive out bad money. Many kings and governments have found to their sorrow and dismay that any attempt to improve the coinage by the issue of many new and full weight coins only resulted in their immediate disappearance from circulation. It was these new coins that were always melted and exported, the light weight and debased coins being left behind. If the coins in circulation have become much worn, the only way in which any government can improve the circulation is by withdrawing the light coins and issuing full weight coins in exchange for them. The loss must be borne by Government, for if it were to accept light weight coins only by weight, people would avoid bringing them to the Government treasuries. All civilised governments

make a practice, therefore, of withdrawing light coin from circulation and bearing the loss entailed in melting up the light coins and re-coining them.

CHAPTER III

DOUBLE AND SINGLE STANDARDS

In former centuries silver coins were the standard money in nearly all countries of the world. The only token money consisted of copper coins. Gold was coined in many countries and gold coins were in circulation to a certain extent. The gold coins were also standard money, because they were coined to an unlimited extent, and were always worth their intrinsic value as bullion. In those days, both in Europe and in India, both gold and silver coins could be melted up for bullion without loss. In certain countries a legal rate of exchange between the gold and silver coins was fixed from time to time by ordinance ; and in such countries there existed then what is called the "double standard." Much difficulty arose, however, from this system of having standard coins of two different metals, both gold and silver, in circulation at the same time, because the rate at which they exchanged for one another was liable to sudden fluctuations in accordance with the price of silver in terms of gold, or, what comes to the same thing, the price of gold in terms of silver.

This was the state of affairs in India before the year 1835. Besides the various silver coins, there were different gold coins in circulation, known as pagodas and gold mohurs. A pagoda was a very

small gold coin about the size of the silver four-anna piece. The gold mohur was a much larger coin covered on both sides with inscriptions in the Persian character, and of about the same weight as the modern silver rupee. These gold coins used to exchange for the different kinds of rupees at rates which varied from time to time according to the scarcity or plenty of gold and silver. The English Governor would fix the rate of exchange between the gold and silver coins, but the Nawab of Arcot, the Nizam of Hyderabad, and the French Governor at Pondicherry, would fix different rates, each according to the plenty or scarcity of gold or silver in his territory, the rate being altered so as to attract the kind of money desired. The rate of exchange actually depended a great deal upon which kind of metal the cultivators preferred for jewellery or hoarding, on the requirements of the merchants who wanted to send money for long distances, and on the occasional large disbursements of silver by the Mughal and European armies. In times of internal warfare, when the soldiers and the tax collectors took all visible wealth, gold was in greater request than silver, because, for a given value, it occupied less bulk and could be the more easily hidden. In peace times, however, the cultivators preferred silver for jewellery.

The foreign trade of the English, French, Dutch and Portuguese was sometimes bringing silver into the country, sometimes gold, and sometimes taking away gold in payment for goods. For all

these causes one metal or the other was frequently getting scarce in a particular territory; so the rate of exchange would be altered to attract the metal back again. It was only the professional money changers and banias who understood the rates of exchange between all the different coins, and became aware punctually of the changes in the legal rate between gold and silver. The unfortunate cultivators and the ignorant public in general were therefore constantly being cheated. Unscrupulous money changers would deceive them, because it was very difficult for the ordinary person to find out what was the true rate of exchange existing at the time.

Exactly the same state of affairs existed in Europe two hundred years ago. In England it was brought to an end by adopting the single standard system and making gold the only standard coin. Such a ratio was fixed for the silver coin that it became a token. The first step towards this was when the guinea was rated at 21 shillings in the year 1717. As this was rather higher than the market price of gold in terms of silver (which was about $20\frac{3}{4}$ shillings for the guinea), it became advantageous to pay for goods imported into England by exporting silver rather than gold, so that England came to have mainly a gold currency. There were naturally slight fluctuations from time to time in the market ratios of gold and silver, but the double standard system continued throughout the eighteenth century. During the Napoleonic

wars, the silver currency became very scarce, only light weight coins remaining in circulation, which is an example of the operation of Gresham's Law. In 1816, after the end of the long European wars, it was decided to reform the English currency system, and the present system was adopted, in which gold is the standard metal and the sovereign the standard coin. The weight of the shilling was reduced slightly relatively to the sovereign so that at the legally established ratio of 20 shillings to one sovereign, the shilling became definitely a token coin ; that is to say, it was worth more as representing the twentieth part of one sovereign than as a piece of silver bullion. The gold sovereign could in fact then buy silver bullion equal in weight to 21 or 22 shillings. This change was made in order to protect the currency against the possible rise of the price of silver, which would lead to its being exported again. That was how the English Government finally settled the difficulty of the constantly fluctuating rates of exchange between gold and silver.

The Indian Government, however, found different circumstances prevailing, and adopted a different plan. At the prevailing rate of exchange between gold and silver, gold had already become very scarce relatively to silver in southern India. At the same time there was great confusion in the silver currency. The standard money in the north of India had always consisted mainly of rupees, but these were of somewhat different

weight in the different provinces. In 1818 the Madras Government adopted a silver rupee weighing one tola (180 grains) as standard, which was in fact exactly the same as the present rupee in weight and fineness. The other parts of India had rupees of various weights and fineness. When trade took place between different parts of India, calculations had to be made according to the kind of rupee in which the price of the goods was to be paid, for rupees of various kinds were used in payment, and they had therefore to be weighed, and were simply treated as silver bullion. This confusion was ended in 1835, when the Government of the East India Company passed an Act which made the Madras rupee the only standard coin throughout the whole of India. Ever since that day these rupees alone have been coined. By the same Act gold was demonetized and gold coins were no longer legal tender money. Silver rupees alone were accepted in payment of revenue and other Government dues. Thus the single silver standard was established in India ; and this currency system lasted without any substantial alteration until the year 1893.

The idea of the double standard was by no means dead, however ; and at various times proposals were made for again introducing gold into circulation. The Act of 1835 had authorised the coining at the Company's mints of a gold mohur of the same weight and fineness as the rupee. This was worth approximately Rs. 15 ; whilst 5 and 10 rupee pieces,

corresponding roughly with the half-sovereign and sovereign, were also coined. Only small quantities were issued, however, as they were not legal tender. In 1841 a proclamation was issued authorising treasury officers to receive these gold coins at their face value ; but in the later forties there was very little gold in circulation. The great discoveries of gold in California and Australia about 1851 led to its being feared that there would be a great influx of gold into India ; and the receipt of gold at the treasuries was discontinued. The actual depreciation of gold which resulted from these discoveries was much less than had been anticipated, so that attempts were made again from 1859 onwards to extend the use of gold coins. Government decided, however, to issue paper currency instead of attempting to put gold into circulation as legal tender.

In 1864 an important step was takēn in authorising the treasuries to receive English and Australian sovereigns and half-sovereigns in payment of Government dues at the rates of Rs. 10 and Rs. 5 respectively. When available, sovereigns and half-sovereigns might also be paid out of the treasuries to persons willing to receive them in settlement of claims against Government. In actual fact, this did not bring sovereigns much into use, for at this time the price of silver was beginning to depreciate. Consequently in 1868 it was notified that the rate at which sovereigns and half sovereigns would be received at public treasuries

would be Rs. 10-4-0 and Rs. 5-2-0 respectively. It is worth while referring to the beginning of Chapter X (page 118) in order to note how this rating of the sovereign corresponds with the foreign exchange rate, which is calculated from the prevailing market rate of exchange between silver and gold.

In 1871 the gold price of silver and the rate of exchange on London began to fall steadily. Further proposals for introducing gold into circulation were made, but again on the double standard basis ; and the Government of India definitely rejected such proposals in 1874. From this time onwards, one party strenuously advocated the closing of the mints to the unlimited coinage of rupees, and another party advocated bi-metallism. "Bi-metallism" means a double standard system with a fixed ratio between gold and silver, which would be maintained by an international agreement, all the principal countries of the world passing similar laws to regulate the relative values of gold and silver. In spite of several International Monetary Conferences being held in Paris, no agreement was ever come to between the principal nations of the world as to the rate of exchange between gold and silver to be universally adopted ; and as India could not act alone, the policy of bi-metallism was definitely abandoned after the failure of the Conference of 1878.

CHAPTER IV

PAPER MONEY

In the last chapter we saw how the currency systems of civilised countries are established, there being coins of one metal, gold or silver, adopted as standard money and several other coins used as token money to represent fractional parts of the standard coin. In the present chapter we shall see that the currency system does not consist only of metallic money ; but in most countries includes also paper money, the use of which is regulated by law.

From very ancient times it has been found that various things can be used to represent coins, either by such a custom arising amongst the people, or by the king or governor proclaiming a law to that effect. For example, in many countries small pieces of leather were used, impressed with the king's seal. Pieces of wood and small flat pieces of burnt clay have been used. The Chinese appear to have been the first to use paper to represent money, which they did many hundreds of years ago. In Europe paper money has been regularly in use for the past three hundred years ; but in India it was unknown before the British rule.

Paper money is issued in the form of a printed note, which reads as a promise to pay the bearer

a certain amount of the standard money of the country on demand. In many countries banks are allowed to issue such notes under strict regulation by Government. From 1770 onwards, several private banks issued notes in Bengal ; and the Banks of Bengal, Bombay and Madras were permitted to issue notes from 1809, 1840 and 1843 respectively until 1862. When a bank fails, however, its banknotes become worthless, or nearly so. There were many cases in Europe and America where banks failed to pay their notes on demand, that is to say, immediately they were presented for encashment ; and similar difficulties had occurred in India. Government desired to supplement silver by the use of some other currency medium, so as to lessen the demand upon the world's supplies of silver and avoid locking up too much capital in unproductive uses. It was considered impracticable to introduce gold into circulation in India; consequently, the only alternative left was to popularise the use of paper currency. As the Honourable Mr. James Wilson, Finance Member, said in his speech, introducing the Paper Currency Bill in 1861, the object at which Government aimed would be accomplished " by having recourse to a sound, well regulated paper currency of general application to the whole of India, and at all times easily and readily convertible into the coin which it represents—a paper currency so well secured that it can safely be made a *legal tender* in all transactions throughout India." It would not have

been right to force the notes of banks upon the public in India ; consequently, Government could not make them *legal tender,* and the circulation of bank-notes must necessarily have remained small.

It was for these reasons that Government decided to withdraw the privilege of issuing notes from the Presidency Banks and to undertake the issue of paper money itself. The arrangements for the issue of currency notes were made by an Act of the Legislative Council in 1861, and the issue of notes commenced in 1862. The first " currency notes " issued, like the present ones, were promises to pay a stated amount of silver rupees at certain Government treasuries. India was divided into a number of " circles " of issue, there being a currency office in each circle. The notes were at first payable only at the office of issue, or in the head currency office of the presidency town to which the circle of issue was subordinate.

It is interesting to see how the use of paper currency has grown in India. The following figures show the total circulation at intervals of ten years from 1865 :—

Date.	Value of currency notes in crores of rupees.	Percentage of increase in the period.
31st March, 1865	7,43	...
31st March, 1875	11,24	51
31st March, 1885	14,58	30
31st March, 1895	30,70	111
31st March, 1905	39,18	28
31st March, 1915	61,63	57
31st March, 1920	174,52	183

The column on the right hand shows the percentage of increase during each successive period of ten years. The rapid growth of the circulation is due to the fact that people gradually became accustomed to the use of notes in the inland parts of India ; but also to the improved facilities for encashment, which were granted from time to time : for example, notes of ten and fifty rupees denomination were made convertible, not only in the circle of issue, but at all currency-offices, and in 1911 the one hundred rupee notes were similarly made universal.

The last period from 1915 to 1920 is five years only, and the percentage rate of increase should therefore be doubled, so as to compare it with the other periods, which makes the figure 366 per cent per ten years. It will be seen that this is a much greater rate of growth than at any previous period. This is due partly to the rise of prices, which is discussed in a later chapter, but also largely to the much greater facilities for the encashment of notes, which were provided in 1915 and 1916. The notes were then made payable at all district treasuries, and at a number of branches of the Presidency Banks. A great improvement was the issue of one-rupee notes in December, 1917, followed shortly afterwards by notes of Rs. 2-8-0. The one-rupee note continues to grow in popularity and has doubtless become a permanent feature in our currency system.

Currency notes of all denominations are "promissory notes," and the promise is to pay

"on demand," that is to say, immediately the note is presented for encashment during the hours when the treasury is open for business. The notes are said therefore to be "convertible," which means that they can be turned into silver money at any time.

There is a danger that paper money may be issued in greater quantity than is required by the public, which may cause prices to rise, and may eventually cause paper money to fall to a discount as against standard money. In some countries, the government, when very short of money, has printed vast numbers of notes and put them into circulation as a means of paying its expenses. This is a very reprehensible practice, as it amounts to defrauding the public by exacting from them a contribution to the government without their knowledge or consent. As will be explained in a later chapter, an over-issue of paper money causes prices to rise, so that the cost of living greatly increases. Persons earning or receiving fixed incomes find their money worth much less than before. What happens is that the putting of a great quantity of notes into circulation actually transfers spending power from the public to the Government which issues the notes. If powerful banks make over issues of notes, the same thing happens ; but the command of wealth is transferred to the banks instead of to the government.

Over-issues have been made by so many countries at different times that it would need a long list to

mention even the important cases. One of the classical examples is the over-issue of the *assignats*, or notes of the French Republic at the time of the Revolution, and other striking examples are the over-issues of paper money by the Government of Brazil from 1889 to 1898 and by the State Bank of the Argentine Republic at various periods from 1826 to 1890.

There was no justification for these over-issues by the South American Governments, because they occurred in peace time and were due to very bad financial arrangements. There is more excuse for governments making big issues of paper money when they are embarrassed by the difficulties of financing a great war. The expenditure is far greater than can be raised by taxation, and the economic situation of a country at war is not favorable for raising money by loans. Consequently the issue of paper money is often the only resource left. As will be seen in a later chapter, this means of financing their heavy expenditure has been adopted by most of the countries of Europe during the recent Great War. The most striking example of what can happen is furnished, however, by the rouble notes now in use in Russia which have been issued by the Bolshevik Government. These notes are supposed to represent one rouble, the rouble being a gold coin worth very nearly the same as the rupee on its new basis : that is, one-tenth of a sovereign. Yet the rouble notes have been issued in such vast quantity that a paper rouble is now

almost worthless. A one-thousand rouble note is worth only about one pice, and the value of the notes is continually falling lower and lower, because they are being printed and issued in such vast quantities that the Bolshevik Government will never be able to pay them in gold or silver. They have become "inconvertible." This is an extreme case, however, and is a desperate resource of a Government which does not know how to govern and is struggling for its very existence.

The Paper Currency Reserve

In order to avoid any danger of over-issue of Indian Currency Notes, Government established by the original Act of 1861 the Paper Currency Reserve, in which a great store of sovereigns and of silver rupees is kept always in readiness for paying the notes in either gold or silver whenever presented for encashment. According to the present law, the reserve may be held up to the amount of Rs. 85 crores in the shape of investments either in England or in India of a kind which bear interest, and which can be easily sold in case it should be necessary to procure gold and silver for the reserve without delay. The remainder of the reserve must consist of actual gold and silver coins held in the Government treasuries in India always ready for payment. At the end of June,

1921, the Paper Currency Reserve was composed as follows :—

	(In lakhs of rupees).	
	22nd May 1920.	30th June 1921.
Coin and bullion—		
Silver coin	35,71	66,86
Gold coin and bullion	42,50	24,35
Silver bullion under coinage ...	4,57	4,20
Gold coin and bullion in England ...	*Nil.*	*Nil.*
Silver bullion in England	*Nil.*	*Nil.*
Gold in transit to India	1,42	*Nil.*
Securities at purchase prices—		
Held in India	28,33	67,99
Held in England	53,77	8,55
TOTAL ...	167,30	171,75

Let us see what are the advantages which the public gain by having paper money issued by Government. In the first place it is light in weight, so that notes representing a large sum may be conveniently carried, whereas one would require a coolie or *thela* to carry the same sum in silver. Also for the storing of money for future requirements notes are convenient, as they take up a small space.

They will be perfectly safe if put in a small metal box, and they may be put away for as many years as the owner desires, because they will always be changed into silver when presented at the treasury, however many years old they may be. If any currency notes which had been hidden away fifty years ago were to be presented now for encashment, they would be paid. Another great advantage of currency notes is that they may be used for sending money by post by the system of registration and insurance.

There are also many advantages to Government in the use of notes. In the first place, the use of a great deal of silver and gold is avoided, which would otherwise have to be bought in foreign countries and coined into rupees and sovereigns. This will be understood if we consider the total amount of money in use in India—silver, gold and paper. It is impossible to say how many rupees are in use ; but we may assume for the sake of argument that the rupees in active circulation amounted to about 270 crores in January, 1920; whilst the currency notes issued amounted to 186 crores.

The figures of silver and gold in the hands of the public are not really known, because so much that is issued by Government is afterwards either exported or melted. The above figures will serve, however, very well for purposes of illustration. It will be seen then that the total amount of money used by the people of India amounts to about 450 crores. At first it would seem that Government, by

issuing paper money, has been able to make a saving in the use of gold and silver to the extent of 186 crores of rupees. This, however, is not the case, because we have to take into account the gold and silver which it is necessary to keep in the Paper Currency Reserve, so as to ensure the notes being convertible on demand. In January, 1920, the amount of silver in the reserve was 42 crores and the amount of gold about 44 crores, a total of 86 crores. Subtracting this from the total amount, we find that there was exactly 100 crores of paper money issued in excess of the metallic portion of the reserve. This sum, Rs. 100 crores, therefore represents the amount of gold and silver the use of which in the country is saved by the circulation of currency notes. The interest upon this great sum of money is provided by the invested portion of the Paper Currency Reserve, and amounts to over 5 crores per annum. If there were no paper money, an additional one hundred crores of silver and gold would have been needed in circulation. This would have been doing no useful service to the country, because paper does the work just as well, so that Government would have been losing interest to the amount of over Rs. 4 crores per annum. If this income were not obtained, taxation would have to be increased.

As regards that portion of the paper currency circulation which is represented by the metallic part of the reserve, namely, 86 crores of gold and silver, there is also some saving. Coins when

passed from hand to hand suffer wear and are reduced in weight, so that after a few years they have to be withdrawn from circulation, and Government then melts them up and re-coins them. In doing this there is obviously a loss. By keeping 86 crores of gold and silver in reserve and putting paper money to an equal value in circulation instead of it, the wear and tear of Rs. 86 crores of gold and silver is avoided. This also is a very considerable saving, probably much greater than the whole cost of printing and issuing all the currency notes, and of replacing notes withdrawn because they are worn or dirty.

CHAPTER V

THE WORK OF A BANK

Banking is the business of dealing in money and credit, and in the remittance of money from person to person and place to place. The office or house in which this business is carried on is called a "bank." The business may be carried on by an individual person or a firm, and these are properly spoken of as a "banker" or "bankers." Such business is often carried on by a limited company, which is then called a "banking company." In ordinary speech, however, the term "bank" is often applied, not only to the place of business, but also to the firm or company which carries on the business.

The business of a banker is of two distinct kinds, which might be carried on separately, but which it is advantageous to combine. The first class of business is to receive money on deposit or loan, for which he usually pays a small rate of interest; and to advance money or make loans to his customers, on which he charges a higher rate of interest. The second class of business is to undertake, on behalf of his customers, the making of payments from one person to another, which frequently involves making remittances of money to distant places and to foreign countries. For making remittances a small

rate of commission is charged, at such rate that the business is profitable. We shall be concerned in this chapter chiefly with the first of these two classes of business, the second being dealt with in the next chapter.

The essential feature of the business of deposit banking is that the banker is a person or firm who undertakes to receive deposits of money from the public and to repay them on demand, that is to say, immediately the repayment is asked for by a written order called a cheque. The banker must obviously be a person of good standing and credit in the eyes of the public, or they would not entrust their money to him. It is essential for establishing his credit, and to be sure of always repaying deposits on demand, that the banker, or banking company, should possess a considerable sum of capital, and he must be ready to employ it entirely in his business of banking.

Banks usually receive money on deposit on various terms. That which is deposited with them on such an arrangement that it may be withdrawn on demand is said to be deposited "on current account." Some banks pay a small rate of interest, 2 or 2½ per cent, on the balance which a customer has with them on current account from time to time; other banks pay no interest on balances of their customers on current account because they are subject to withdrawal without notice. If the customer is certain that he will not require to use his money within a short period, he may place it on

"fixed deposit" with the bank, that is to say, on an arrangement to leave it with the bank for a fixed period, or subject to a certain number of months' notice. The banker is then in a position to use the money in a more profitable form of investment, and he is ready therefore to pay interest, and to pay a higher rate of interest the longer the period of notice of withdrawal that he receives. For example, many banks in India will pay on fixed deposits subject to three months' notice, interest at the rate of 3 per cent per annum, for six months' notice 4 per cent and twelve months' notice 5 per cent.

The total fund of money available for the banker to utilize is made up then as follows :—

(1) His capital.
(2) Deposits on current account.
(3) Fixed deposits.

Separate accounts are kept of course for each of these, and with each customer ; but all the monies thus available are mixed in one fund, and are at the banker's disposal to employ as he thinks fit in banking business. The manner of employing the available funds is the whole secret of safe and successful banking. It must be understood that the banker is severely limited as to the proper use to which he may put his funds by the conditions on which he has accepted money from the public, and which he is bound to fulfil both for his own credit and in the eye of the law. We shall understand the banker's position better by comparing his business

with that of companies which also receive money, but on different terms.

First let us take as an example the "building companies," which are also sometimes established as co-operative societies. Such a building company, or society, is formed by a number of persons who buy so many shares and thus provide a certain amount of capital. The company, or society, also accepts loans or fixed deposits for long periods, two or three or five years, but it does not accept any deposits repayable on demand. Its own capital and the money received on deposit are lent out to the members in order that they may buy or build houses. The loans are made on the security of mortgages of the houses, and usually the loan is made repayable by instalments. The company, or society, makes its profit by receiving on the loans interest, say, at 6 per cent, whilst it pays 4½ or 5 per cent on the fixed deposits. It is in a very secure position, because it lends only to the amount, say, of two-thirds or three-fourths of the market value of the house, and also insists that the house be mortgaged to it. It is entitled, therefore, to take possession of the house and sell it in order to recoup itself if the borrower fails to pay interest or repay instalments of the loan on the agreed dates. The one thing which a building company, or society, cannot do, however, is to realise its capital quickly. Its money is all lent out on the security of the houses, and it is agreed to be repaid on certain dates, and the company cannot

get the money back at any earlier time.

Let us take another example. There are in England and other countries many investment companies, or "investment trusts," as they are sometimes called. These are large companies, the shares of which are bought by many persons. When investment trusts accept loans, it is only in the form of what are called *debentures,* which are only repayable after a long period—twenty or thirty years. Such companies then invest their funds in the shares of other companies—railways, mills and various industrial concerns. The dividends received from the shares are applied first to pay the interest on the debentures, and the balance is divided amongst the shareholders of the investing company.

It is a dangerous business for a bank to try to act like a building society or an investing company; yet many banks have failed and involved depositors in heavy losses simply because they have ignored this good rule of banking. If a banker lends money on the mortgage of house property or zemindary, it is often impossible to get repayment of the money just when the bank wants it. The borrower is not in a position to repay, and if the banker decides to sell the property mortgaged to him, he may find this difficult. There may be no purchaser available, or the highest price offered may amount to less than the loan. In any case, it takes some weeks or months to get the sale of landed property completed. Again, the banker

ought not to act as if his bank was an investment company by putting his funds into the shares of railways and industrial concerns. It is true that the shares of well known and successful railway companies, like the East Indian Railway and the Great Indian Peninsular Railway, always find ready purchasers ; they can be sold any day at a market price which is well known on the stock exchanges of Bombay, Calcutta and London. But the matter is quite different if the banker puts his funds into the shares of a small branch line company, or a new cotton mill or factory, or worse still, a coal mine or oil prospecting syndicate. In the latter case, there is great risk that the venture may turn out altogether a failure and the money be entirely lost. In the case of a branch line railway or a cotton mill, the money may really be safe enough, but profits may not be earned for many years, and in the meantime it would be impossible to find purchasers for the shares except with difficulty, and probably for less than the bank paid for the shares. The buying of such shares should be left for private persons or an investment company. The latter puts its money into so many different companies that, if one or two fail altogether, and some others fail to pay any dividends for the first few years, the investment company does not really suffer, because it is sure to be getting profitable dividends from some of its shares.

We see then that the proper business of the banker is to avoid locking up his money by lending

it out on mortgages of land or houses, or by investing it in industrial undertakings. His object must be so to utilize his funds that they can be recovered after a short interval, if they should be required to meet demands of depositors to withdraw their money. The method which bankers prefer is to utilize their funds by advancing on the security of hundis or bills of exchange. When a merchant sells goods to another merchant or to a manufacturer, he draws a bill or hundi for the amount of the purchase money, the bill becoming due after a stated interval of one, two or three months. The bill or hundi is presented for acceptance to the purchaser of the goods, and when he has accepted it the bill is said to be negotiable, provided the drawer and the person on whom it is drawn are both of good credit. The drawer will take such an accepted bill to his banker, or if he has not an account with a bank himself, he will take it to a shroff who will pay him the discounted value of it and then endorse it and himself take it to the bank. In either case, if the names on the bill are considered good enough, the banker will "buy" or "discount" the bill, that is to say, he will give the full amount for which the bill is drawn less a discount, which represents the interest due upon the amount which is advanced during the period before the bill matures and becomes payable. The advantage to the banker of this form of investment is that he knows exactly when the bills will mature and therefore when the advance will be paid off. If there

should be a pressure to withdraw money from the bank, he has only to stop discounting new bills, and the old bills which are maturing are constantly supplying him with funds. The same is true, however, of any short period loans which are certain to be paid off at a given date, or which are made to persons who will be in a position to repay after short notice if repayment should be requested by the bank. To persons of good standing, particularly persons of high character and energy well known to the banker, or persons in receipt of ample fixed salaries, the banker will advance moderate sums without security, as the borrower can easily repay the bank with two or three months' notice, and the banker can trust him to do so. In many cases, however, banks do not care to trust to the discretion of their managers in making such personal loans, and they require that there shall be some *collateral security* as it is called. If the person who desires to borrow from the bank can find some substantial person who will guarantee repayment at short notice, that will satisfy the bank. A very frequent custom, however, is to deposit some easily marketable goods as security. If the borrower has gold or silver, or jewellery or precious stones, of considerable value, the banker will advance against these as security up to, say, one-half of the estimated value, because they can be easily sold if the borrower fails to repay. The best form of "marketable" security, however, is an easily saleable investment, such as bonds, or stocks and shares of large and

well known companies. The banker will always advance against the security of Government Promissory Notes, War Loan bonds, municipal and port trust loans, and the shares of the big railway companies, and a few big steamship and industrial companies which have been paying steady dividends. The prices of such securities are quoted daily on the stock exchanges, which is one reason why the banker likes them, because he can immediately ascertain the market value of the security, and can arrange to advance three-fourths or four-fifths of the value, allowing a margin both for depreciation of the investments, and to secure to the bank the interest which will accrue.

So much then for the profitable use of his funds by the banker. It will not do, however, for the banker to pay out all his available money in discounting commercial bills and in short time loans ; for he has always hanging over him the obligation to pay money to his depositors on demand. He must, therefore, always keep a considerable part of his total fund in actual cash in the bank itself—carefully guarded in safes and underground strong rooms. The head office of a bank will have many lakhs of rupees in actual silver, and perhaps twice as much in currency notes in its strong rooms, and a certain amount of gold coin and gold in bars. It can pay its customers in silver, or currency notes, or sovereigns, as they are all legal tender, but it cannot offer them hundis or coins of other countries. It is obviously unprofitable for a bank

to keep much of its funds in the form of actual money locked up in safes, because such money is idle and earning no interest; whereas if such money were lent out, or otherwise invested, it would be earning interest. The banker therefore keeps his reserve of cash as low as he possibly can consistently with safety, and invests a portion of his funds in Government Promissory Notes, Government loans, and other gilt-edged securities, which can be sold on the stock exchange at a moment's notice by telegraphing to his broker.

CHAPTER VI

BALANCE SHEET OF A BANK

Having seen in the last chapter how the work of a bank is carried on, we are now in a position to understand the *balance sheet* of a bank—a document which to the initiated shows its financial position at a glance. In the last chapter we looked at the question of the business of banking largely from the point of view of the banker himself. We shall now consider banking from the point of view of the customers, that is to say, the public which proposes to use the facilities offered by the banks. As has been explained, the two chief services which a bank renders are, firstly keeping safely money deposited with it, always being ready to pay it back to the depositor either on demand or after notice, as may be arranged ; and secondly facilitating the remittance of money from person to person and from place to place.

It is all very well for a banker to undertake to carry out these services. Anybody may make promises ; but the question is whether he may be expected to fulfil them. This question of the confidence of the public in the banker's promises of repayment lies at the very foundation of successful banking. There are two chief ways in which a person or company trading as a banker may gain

credit : (1) by being scrupulously careful to make all payments on the due date or when demanded, so that he gains a reputation for always being able and ready to pay ; and (2) by possessing a large amount of property, and letting the public know that the total wealth which he owns is a much greater sum than what he owes—or putting it in technical language, that his assets exceed his liabilities. A company does this by publishing its balance sheet, and some private firms of bankers do the same.

It is convenient to take an example, and we may examine therefore item by item the figures given in the balance sheet printed on page 46. The balance sheet has two sides, termed respectively "Liabilities" and "Assets." The liabilities of a bank consist of all sums of money whatsoever that it owes temporarily or permanently; and the assets include the property of the bank, and the amounts which are owing to it, and are expected to be paid to it in money in due course. The assets represent therefore all the money and property which are available for paying the debts or liabilities of the bank, or will be available as soon as they are realised. Let us now examine each item separately, taking the liabilities side first. Here we see that the first item is "share capital authorized" which means the amount stated in the Company's Memorandum of Association and for which it has paid the prescribed registration fee. The "share capital subscribed" is put in merely to inform the public what amount

of shares has been subscribed. The next item (2) shows how much capital has been paid up by the shareholders. We see that in this case only half the subscribed capital has been paid up, which means that the directors of the bank have not thought fit to call upon the shareholders to pay the remaining one-half of the shares for which they have subscribed. This remains as a liability upon the shareholders. The practice of leaving share capital uncalled is generally regarded as strengthening the position of the bank, because it means that it has a reserve of money to fall back upon which can be called up from the shareholders in case of necessity.

Balance Sheet of a Joint Stock Bank at 31st December, 1919.

Liabilities.			Assets.		
	Rs.			Rs.	Rs.
(1) Share capital { (*a*) authorised ...		1,00,00,000	(1) Reserve—		
{ (*b*) subscribed ...		80,00,000	(*a*) Cash in hand ...	51,07,418	
(2) Ditto paid up		40,00,000	(*b*) Cash at bankers and loans at call and short notice ...	32,15,469	
(3) Reserve fund		18,00,000	(*c*) Government & other securities (at or under market rate)	72,45,153	1,55,68,040
(4) Deposits on current account ...		2,47,14,788			
(5) Fixed deposits		1,84,23,561	(2) Bills discounted and purchased ...		1,63,40,511
(6) Bills payable		89,414	(3) Loans and advances		1,83,21,446
(7) Bills receivable as *per contra* (on account of customers acceptances) ...		2,41,583	(4) Bills receivable (liability of customers for banks acceptances) ..		2,41,583
(8) Profit and Loss Account : Brought forward from last year ...	4,32,142		(5) Bank premises and furniture, etc. ...		1,71,481
Add profit of 1919 ...	11,41,573				
Total ...	15,73,715				
Deduct interim dividend at 10 per cent paid for half-year ...	2,00,000	13,73,715			
Total ...		5,06,43,061	Total ...		5,06,43,061

(3) The *Reserve Fund* is a little difficult to understand, and must be carefully distinguished from the *reserve* which is shown on the assets side. The reserve fund is really the accumulated profits of past years—profits which have not been paid out as dividends, but are being utilized in the business of the bank, as if they were part of the share capital. It is for this reason that they are set aside as a reserve fund. It would have made no difference to the balance sheet, however, if these undivided profits, instead of being called "Reserve Fund" were added to the amount brought forward and shown in item (8). It would then be Rs. 22,32,142 instead of Rs. 4,32,142.

Items (4) and (5) will be understood from the explanation of the bank's business given in the previous chapter (see page 34).

Item (6) *Bills Payable* means bills which the bank has drawn upon its branches or its agents in other places, or other countries and has sold for cash. These bills are sold for the convenience of people wishing to remit money, and they will have to be paid by the bank when presented.

Item (7) represents bills which the bank has accepted on behalf of customers—that is to say, it has promised the drawer to pay them in the expectation that it will recover the amount from the customers on whom they are drawn. Banks will only accept bills on behalf of customers of very good credit. Bills so accepted are undoubtedly a liability, as the bank has agreed to pay them, but

they are also an asset as the customer is expected to refund the amount to the bank. It will be observed therefore that exactly the same sum appears on the asset side. Customers' bills accepted by the bank represent therefore what is called a *contingent liability,* that is a liability which will have to be paid only under certain circumstances—usually if something goes wrong.

The last item (8) is not really a liability, but represents the balance of assets over liabilities. If the bank has been making a profit, the total of the assets increases during the course of the year relatively to the liabilities. If no dividends were to be paid, then the profits would go on accumulating and the assets would go on mounting up till they became much larger than the liabilities. When profits are paid out in the form of dividends, they are of course gone from the bank and they disappear from the balance sheet. Accumulated profits must, however, be shown. In this balance sheet that is done by showing the amount of profits brought forward from the last year, and showing the profit made during the present year. From this, however, has to be deducted Rs. 2,00,000, which was paid out as dividend at the rate of 10 per cent per annum calculated for the first six months of 1919 ; and this balance sheet therefore correctly represents the profits actually in hand at Rs. 13,73,715.

Turning next to the assets side, we find that item (1) consists of the *Reserve.* This is divided into

three parts : (*a*) cash in hand, which includes silver and gold coin and currency notes ; (*b*) "cash at bankers" and "loans at call and short notice." This bank has some of its money on deposit with the Imperial Bank, which is a convenience for the purpose of clearing cheques as will be explained in the next chapter. Some of its money it has lent out to big financial firms which have promised to repay it "at call," which means a few hours' notice, or at short notice which means up to about seven days' notice. Item (*c*) of the reserve is the investment in Government and other easily marketable securities, referred to above (page 42).

The two large items, "Bills discounted and purchased" and "Loans and advances" have been sufficiently explained above, as also "Bills Receivable."

Item (5) "Bank's premises and furniture" represents either the original cost, or the present estimated market value of the bank's premises, which means the houses in which are situated its head office and branches. The value of the furniture is also included, but this should be "written down" each year by appropriating a certain sum from the profits of the year to represent the depreciation of the furniture, as the market value of the fittings and furniture of the bank is usually much less than its original cost.

The balance sheet of a banker cannot be interpreted in the same way as that of a trader ; for there is a peculiar feature about the solvency of a

banker. When a private firm or trading company has assets greater than its liabilities, it is solvent ; but the obligation of a banker is always *to pay instantly when demanded.* This may prove impossible although the assets exceed the liabilities ; for the depositor who wants his money back will not accept a part of a house, or a share in a zemindari, nor yet Government Bonds in payment—neither will he wait. He is entitled to receive money ; and if the bank has not a sufficiently large reserve of ready cash, it may be unable to pay and may become insolvent, although, if it had time to realise its assets—that is to sell its house property, bonds and shares, and to recall its loans to customers—it would be perfectly able to pay. Many banks have been wound up simply because they could not pay when the depositors demanded their money ; but the result of liquidation showed that the value of the assets exceeded the liabilities. A recent case in London was the Birkbeck Bank ; and in the case of the Peoples' Bank, Lahore, a careful liquidation extending over several years enabled all depositors and share-holders to be paid in full.

The ability of a bank to meet its liabilities is to be judged from its balance sheet. There are two tests which are usually applied for this purpose. On turning back to page 46 it will be seen that the first item on the assets side is called "Reserve." The total assets of the bank come to over Rs. 5,00,00,000 ; and out of this total about Rs. 1,55,00,000 constitutes the Reserve, which con-

sists of assets in three forms : (*a*) cash in hand—that is to say, money—both coin and currency notes ; (*b*) cash at bankers and loans at call and short notice—money which the bank may have deposited in an account which it finds it convenient to keep with the Imperial Bank, and perhaps also with an Exchange Bank, and loans which are made to financial firms, and which are repayable "at call," or on short notice ; (*c*) Government and other securities, which are actual investments held by the bank itself in Government Promissory Notes, bonds and stocks, shares of railway companies, and other first-class securities, which can be sold at any moment on the stock-exchange should occasion arise. It will be seen that the whole of the funds of the Reserve, constituted as above described, consist either of actual cash or are convertible into cash in a very few days' time. Supposing that there were to be a run upon the bank and heavy withdrawals of deposits, the banker would meet them first from this reserve; though of course he would take every step possible to reduce his money outstanding in loans and bills discounted. Old bills would mature, and no new ones would be purchased.

One test which should be applied to the balance sheet of a bank is the percentage which the reserve bears to the total assets. In the example here described it is 30.7 per cent, which may be considered a satisfactory proportion, though many banks make a practice of keeping a somewhat higher per-

centage. Any bank whose reserve is less than 25 per cent of its total assets may be in a weak position ; and the public should either avoid making deposits with it or at least scrutinize its balance sheet carefully and apply the second test to be now described.

The solvency of a bank depends more than anything else upon its ability to meet withdrawals by cheques on current account, which have to be paid on demand. It will be readily understood, therefore, that a certain latitude may be allowed to a bank as regards the proportion which the Reserve bears to total assets in accordance with the character of the business which it does. A bank situated in a large commercial centre like Calcutta or Bombay will most probably have most of its deposits on current accounts ; but banks of the smaller towns, especially those which are not great trading centres, are very largely merely " safe deposits " for the savings of the local residents. It is a convenient form of investment to put money on fixed deposit with a local bank. Consequently, a bank which does business only in the mofussil may be expected to have a larger proportion of fixed deposits ; and when this is the case the reserve may be safely kept at a somewhat lower proportion to the total assets, the reason being that the fixed deposits take time to mature, and become payable to customers at various dates, just as the bills discounted and loans advanced become payable to the banker. Thus, time for realization of assets will

be available provided the banker has not tied up his money by any mortgages on houses and land or by investing his money in companies whose shares are not dealt with on the stock exchange.

It will now be readily understood that the really vital element in the banker's balance sheet is the proportion of the reserve to the deposits on current account. Generally speaking, it may be said as regards banks in India the reserve as a whole should amount to not less than half the deposits on current account, and that the actual cash in hand (meaning sovereigns, rupees and currency notes) should not be less than one-fifth of the deposits on current account.

There are other features of the balance sheet which are well worth observing, namely the proportion of the paid-up capital and " surplus reserve fund " taken together relatively to the total liabilities ; and furthermore whether the shares are fully paid-up or not. It is obviously not good policy for a bank to try to do a very great amount of business on a small capital. If a bank with only a small capital had accepted deposits to the amount of, say, twenty times its capital, it might in the last resort become insolvent even though it did keep a very large reserve, and a great part of it in cash. A person who puts his money on deposit in a bank will do well to consider the ultimate possibility of the bank being wound up, if, for example, a banking crisis were to recur like that of 1913. The question would then arise what amount of the assets

might prove to be unrealizable or partially so. Some loans which the bank had made without security, or on security which had subsequently depreciated in value, might be only partially repaid, or be wholly lost. In such a financial crisis too the value of Government and other securities on the stock-exchange would fall considerably; and so the value of this part of the Reserve would decline.

If the assets, on actual realization, fall short of the liabilities, the deposits made with the bank and the bills which it has accepted are paid first; and the balance of the assets, if any, is distributed amongst the share-holders at so many annas in the rupee. It is obvious that if the share capital be small, there is so much the more likelihood that when a part of the assets are found to be unrealizable, the total available may not be sufficient to pay all the creditors—so that it may not be possible to pay the depositors in full. On the other hand, if the capital be large relatively to the total assets, there is so much the greater margin to allow for the worthlessness of some of the assets and for depreciation of others.

In estimating the proportion of the capital to the total liabilities, however, for this purpose, a correct estimate is not obtained unless account is also taken of the surplus reserve fund. This, as was explained previously, (see page 47) is not to be confused with the reserve which is part of the assets. The *surplus reserve fund* (called merely

"Reserve Fund" in most balance sheets) represents the accumulated profits of previous years which have not been paid out as dividends. As the money is kept in the bank, instead of being paid out to the share-holders, it remains as part of the working capital of the bank; and furthermore it belongs to the bank quite as much as the money originally subscribed by the share-holders and represented by its share capital.

If the capital of a banking company is not fully paid up, this represents an additional feature of security to the depositor, though he must not be misled into attaching too much importance to it. A banking company is usually registered under the Joint-Stock Companies Act, and as such three forms of capital are recognized. In the first place, there is the "Authorized Capital" of the company. This means merely the amount of capital for which the company has registered itself and on which it has paid the registration fee. It is the maximum amount for which subscriptions to shares may be received without going through the formality of increasing the capital and paying an additional fee. Next, there is the "subscribed" or "issued" capital. This means the total nominal value of shares for which persons have subscribed and paid the instalments due on application and on the allotment of shares. The subscribed capital may be either "fully paid" or "part paid." A share is fully paid when the money equal to its nominal value has been paid to the company. Many com-

panies do not call upon their share-holders to pay immediately the whole amount for which they have subscribed. The shareholders are allowed to pay by instalments extending over several months, or longer. In some cases, a part of the capital due from the subscribers on each share remains uncalled for an indefinite period—for many years. This is a practice purposely adopted by banks; because the directors always have power to call up the unpaid instalments at any time on giving one or more months' notice. The capital is purposely left unpaid so that it may operate as an element of security to depositors and give confidence to the public. If the bank should go into liquidation, and if on realization there should prove to be a shortage of assets, there is a legal liability resting on the share-holders to pay up the balance of the unpaid capital on the shares which they hold ; and out of this the deficiency in assets is met. It is obvious, however, that much depends upon the proportion which the unpaid capital bears to the total " outside liabilities," by which is meant the liabilities to depositors and holders of bills. If the unpaid capital is less than ten per cent of the outside liabilities, it constitutes only a small degree of protection.

In this connection it is also worth noting that it is an element of strength if the unpaid shares of the bank are " widely held," which means are held in small amounts by a large number of persons. If this be the case, it is not likely that there would be

any difficulty in securing the payment of almost the whole of the unpaid capital if necessity should arise. On the other hand, suppose that the whole capital of the bank is in the hands of a few persons, nine-tenths of it being owned by three persons and the remaining tenth by, say, 20 people. If the three large holders of the shares are commercial men with heavy financial commitments in their own private trading, it is quite likely that they might be involved in financial difficulties at exactly the same time as the bank if a general commercial crisis were to cause a run of depositors to withdraw their money.

On referring again to the balance-sheet printed on page 46 it will be seen that it illustrates the various points which have just been referred to. The authorised capital is Rs. 1,00,00,000, but of this only Rs. 80,00,000 has been subscribed and issued. On the shares issued the Directors have only called up one-half, so that the paid-up capital is Rs. 40,00,000. There is consequently a reserve liability on the unpaid capital of Rs. 40,00,000. The balance of the authorised capital not issued counts for nothing—it is merely a power to take more subscriptions. Item (3) on the liabilities side is the surplus reserve fund. This amounts to Rs. 18,00,000, and adding this to the Rs. 40,00,000 we find that the capital owned by the banking company is Rs. 58,00,000. To complete our analysis of the balance sheet, we ought, however, to take account of the "carry forward." Referring to item 8, "profit and loss account," it will be seen

that a sum of Rs. 4,32,142 was brought forward from the last year. The profit made in 1919 is taken from the profit and loss account and brought into the balance-sheet here, because money earned as profits on the business is money actually in the possession of the bank and belonging to it, and is therefore represented in the assets. As soon as the profits are paid out by way of dividend, of course, they disappear from the assets, and must at the same time disappear from item (8), which, together with the surplus reserve fund, is the balance of assets over liabilities. It will be seen that in this balance-sheet the whole profit for the year 1919 is shown, whilst in reality Rs. 2,00,000 has been already paid out as "interim dividend" at the rate of 10 per cent per annum for the first six months of the year. This dividend paid out is, therefore, deducted from the sum of the money brought forward and the profits of the year, leaving Rs. 13,73,715 as profits available for distribution.

It is entirely a question for the company itself, acting usually on the recommendation of its Directors, as to how much of this profit is paid out. The company is legally entitled to pay out the whole of it in dividend—indeed, it could go further and pay out at any time by way of dividend to the share-holders the surplus reserve fund of Rs. 18,00,000, for this is all accumulated profits. However, if the Directors are wise, they will recommend the company to pursue a conservative policy, and to increase rather than decrease the amount to

be carried forward. If from the amount available, Rs. 13,73,715, a sum of Rs. 8,00,000 is used to pay the final dividend of the year (at 20 per cent), the two dividends taken together will amount to 25 per cent on the paid-up share capital; and there will remain Rs. 5,73,715 to be carried forward to the next year. This would be regarded as rather a large figure ; and the Directors would probably decide to recommend that out of it another Rs. 2,00,000 be considered as added to the surplus reserve fund, making it up to Rs. 20,00,000 and leaving as " carry forward " Rs. 3,73,715.

Legal Restrictions on Joint-Stock Banks

Every banking company worthy of confidence prints a balance-sheet at least once a year and makes it available at its head office and branches to any person who asks for a copy. Such balance-sheet will usually be in the same general form as that given on page 46 and will give the information required for forming a judgment of the financial position of the bank according to the rules of criticism given above. The reader must be prepared, however, for modifications in the method of statement. Some banks give information in much greater detail, whilst others combine the various items into lump sums, so that important information is withheld, whether intentionally or not. A peculiar variety of investments may be covered by the heading " other securities." If the total under this heading seems large in proportion to the total

assets and to "cash in hand and at bankers," the balance-sheet is not one to inspire confidence. Again, some banks fail to distinguish between deposits on current account which are withdrawable on demand, and fixed deposits.

The numerous failures of banks which have taken place in past times in all countries, involving depositors in heavy losses, have led to attempts at the legislative protection of the banks' customers. There are not many cases in which Governments have gone so far as to make official inspections of banks from time to time to see that they carry on their business properly; although there would seem to be no reason why a bank should not be inspected for the protection of the public against bad management amounting to fraud when factories, workshops and mines are regularly inspected for the preservation of safety and health. In most countries the extent to which the Government endeavours to protect the public is restricted to requiring the publication of information, it being presumed that the public when possessed of this information, can itself judge of the soundness of the bank.

In England all Joint-Stock Companies are required to publish balance-sheets twice every year. The Indian Joint-Stock Companies Act (1913) also requires special information to be published by Joint-Stock Companies carrying on the business of banking. Every banking company must before it commences business, and also on the first Monday

in February and the first Monday in August make a statement showing the authorized, issued and paid up capital, and the liabilities and assets of the company. The amounts of the debts owing by the company must be shown separately under the following heads :—(1) under decree, (2) on mortgages or bonds, (3) on notes, bills or hundis, (4) on other contracts, which includes deposits, (5) on estimated liabilities. The assets on the same date are to be shown under the following heads :— (1) Government securities, which are to be enumerated, (2) bills of exchange, hundis and promissory notes, (3) cash at bankers, (4) cash securities.

The information required to be given under this Section of the Indian Companies Act cannot be regarded as sufficient for the protection of the public. It is of interest to note that the Companies Act of Baroda State requires fuller information as to the character of those assets of the company which consist of loans and advances made by the bank. The totals are to be specified under the following heads :—

(1) (*a*) Debts considered good ;
(*b*) Loans fully secured by the deposit of marketable securities;
(*c*) Loans fully secured on the assets of Joint-Stock Companies;
(*d*) Loans on the joint personal security of two or more persons;
(*e*) Loans on the personal security of the debtor alone;

(2) (*a*) Debts considered doubtful fully provided for;

(*b*) Debts due by Directors or other officers of the Bank or any of them either severally or jointly with any other persons included in the above.

Two of these items call for comment. Many banks have come to grief, or at least become involved in difficulties, through large loans having been made to the Directors personally without such security having been taken as would have been required in the case of a member of the public. The Director has in fact used his influence as a member of the Board to obtain funds to carry on his own private business, which may be of a highly speculative character. There are even cases of banks having been floated with the special object of providing the Directors with funds for their own purposes. This amounts to a fraud upon the public and should be severely checked by the law. However, when the statement is required, cautious people are protected. It may be observed, however, that under another heading should be stated loans made to managing agency firms to which Directors belong. This again is necessary because it might be almost as risky lending to the firm as to the Director himself. The security must vary of course entirely according to the status of the managing agency firm, and it would appear necessary that the names of the firms in which the Directors are interested and the amount of advances made to

each should be stated. The form of statement required by Baroda State does not give all the information which is necessary for judging the position of a bank. It is satisfactory to know that the Government of India has under consideration proposals for revising the form of statement to be made by the banks in India with a view to giving further protection to the public.

CHAPTER VII

THE GROWTH OF BANKING

The history of banking in India, when it comes to be written, will be a story of the greatest interest to students of economics and finance ; but the time is not yet. We are in a transition stage. The development of Joint-Stock banking is taking place faster than ever before : it has spread to the Native States ; a tentative beginning has been made with a net-work of branches ; and a new species—the industrial bank—has come and found welcome. We can discern various tendencies of growth ; but these may take long to mature. Whatever the future may hold in store, at least of this we may be sure, that fifty years hence the present period will be regarded as having been an important and critical stage in the growth of banking in India.

It must be borne in mind that there has never been a sudden invention, or sudden introduction, of banking into India. Trade with distant places has existed for many centuries, and such commerce has always required to be financed ; and certain merchants therefore have always made it more or less their special business to deal in the finance of trade. In principle there is no difference between the transactions of the mahajan, the shroff and chetty and those of any private banking firm in any

country, excepting that the former often combines trade with his business of finance, and that the latter has developed a system of payment by cheques. The great difference of modern banking on European lines from the indigenous financial business arises from the growth of a large number of Joint-Stock Banks and the universal use of the cheque as a means of remittance, by the mechanism which will be described in the next chapter.

The mahajan, shroff or chetty, who is to be found in every market town throughout India, may be properly called a private banker. He accepts loans or deposits from various people in his town, and sometimes these are repayable on demand. He discounts, or buys, hundis, that is bills of exchange, offered by his local customers, or cashes those drawn upon him by firms well-known to him in other towns. If a merchant has to make a payment in another place, he goes as a matter of course to the mahajan or shroff with whom he does business and buys a hundi upon that firm's agent in the other town, the hundi being either payable on demand, or a certain number of days after sight, as may be agreed. This is precisely similar to buying a draft from any joint-stock bank.

In all countries the private banker had developed his business long before the joint-stock banks appeared upon the scene. The difference of the private bankers of the 18th century in England from those of India was that the former issued bank-notes or promises to pay a fixed sum on demand.

These notes were like currency notes, and did not bear interest ; and of course they circulated only in the locality where the firm issuing them was well-known and trusted. In exceptional cases the notes issued by big private bankers of London, Liverpool, and other cities became well known throughout the country and were used as a means of remittance ; but this position was rapidly taken by the Bank of England notes. In India the private bankers seem never to have issued notes of this description ; and since 1864 when the Government Currency Notes were established, it has been illegal for any bank or person to issue promissory notes payable to bearer on demand. A further difference lies in the fact that the private bankers in England developed the cheque system at an earlier stage; though it was not until after banks had existed there for 150 years that the cheque almost entirely supplanted bank notes as a means of payment and remittance.

Banks managed upon European lines in India were not at first joint-stock banks ; nor are they entirely so at the present day. Some of the bigger firms of English merchants in Calcutta established banking departments separate from their other business ; as, for example, Messrs. Alexander & Co., whose bank flourished for about 60 years, until the firm failed in the crisis of 1832. At the present day Messrs. Cox & Co. and Messrs. Grindlay & Co., and other such private firms, carry on an extensive banking business, side

by side with their general agency business.

The early development of the English managed banks was entirely in Calcutta and the Bengal side. In 1790 there existed in Calcutta the "General Bank of India" and the "Bengal Bank"; but the latter failed in 1800. In 1806 was opened the "Bank of Calcutta"; and three years later this Bank received a Charter and changed its name to the Bank of Bengal, which is the oldest existing bank in India. Several new charters varying the privileges and restrictions on the Bank were issued before 1876, when the Presidency Banks Act placed it practically on the footing on which it remained till January, 1921. From very early days the Bank of Bengal was restricted, with the concurrence of its Directors, to dealing only in bills of exchange payable in India, thus avoiding the profitable but risky business of dealing in foreign exchange.

The Bank of Bombay was established by an Act of the Legislature in 1840 and the Bank of Madras in 1843. In 1868 the Bank of Bombay went into liquidation as a result of heavy losses caused by the great cotton speculation at the time of the American Civil War. The liabilities of the Bank were eventually paid up in full, but the shareholders lost most of their capital. The second Bank of Bombay, lately merged in the Imperial Bank, was formed in the same year with a capital of one crore, half being paid up then and the remainder a few years later.

The three Presidency Banks have always held

a unique position in the Indian banking system. Until 1876 Government was a shareholder of each Bank ; and large Government funds have always been deposited therein. Government has maintained a continuous policy of reliance upon the Presidency Banks as the central feature of the banking system and commercial finance of India, and as an integral part of the Indian Treasury system. On account of their special position the Presidency Banks were not registered under the Joint-Stock Companies Act ; but were incorporated each by special Charter granted under the Presidency Banks Acts. In these Charters restrictions were made as to the character of the business which the Banks might transact, with a view to ensuring their stability. In course of time each Bank opened numerous branches so as to extend its business throughout its ' hinterland,' or mofussil, dependent on the Presidency town. The Bank of Bengal many years ago opened branches so far north as Allahabad, Agra, Delhi and Lahore. In later years it opened branches in Burma and the Central Provinces. In 1919 it had 26 branches, three of them being at Calcutta; and its operations covered a far larger part of the Indian Empire than those of either of the other Presidency Banks. The Bank of Bombay in 1919 had 18 branches, and the Bank of Madras 26 branches. The latter was perhaps the most enterprising in developing the up-country business by branches in comparatively small towns.

The inactivity of the Bank of Bengal in extending its branches in Northern India allowed room for the early growth of Joint-Stock banks doing business wholly within India. We need not regret this former policy of the Bank of Bengal; for it allowed the Allahabad Bank to be established in 1865, the Alliance Bank of Simla to be founded in 1874, and the Oudh Commercial Bank in 1881. These supplanted two or three earlier private banks, such as the Simla Bank founded in 1874, and the Agra Bank founded in 1833 which survived till 1900. The early joint-stock banks were all under European control and management; but during the past 15 years a number of important joint-stock banks have been established under Indian boards of directors, or with mixed boards, and their share capital almost entirely subscribed by Indians. Many of these were established with insufficient capital paid up, and their cash reserves were insufficient, whilst they locked up their assets in mortgages on real estate or by investment in shares of industrial companies. The banking crisis of 1913 was the most serious since 1868. It arose mainly from such faults of organization and management.

As always happens in a financial panic, when once a single bank fails people begin to suspect others, rumours are circulated, and the most nervous people begin to withdraw their deposits. Well-managed banks can stand a moderate run and pay out all that is demanded; and thus they rapidly

re-establish confidence. But the beginnings of a run find out the weakness of a badly managed bank. Its cash reserves are all used up and it is obliged to suspend payment. The principal failures in 1913 were the Indian Specie Bank and the Standard Bank, both of Bombay ; the Peoples' Bank of Lahore and the Bank of Upper India, Meerut. The first three and some others were liquidated and the assets distributed, whilst the Bank of Upper India was taken over by the Alliance Bank of Simla in 1916.

A few words may be said as to the striking policy of amalgamation and extension which has been initiated in recent years by the Alliance Bank of Simla ; because it is the only parallel in India of those important movements of amalgamation which have affected all banks in England and Scotland during the past thirty years. As a result of many successive amalgamations there are now in England some seven or eight great Banks, each having hundreds of branches extending all over the country in every small town and suburb. The Alliance Bank since 1915 deliberately set out on a policy of amalgamation which would extend the Bank's operations throughout all the towns of Northern India and all the chief commercial centres of India. Besides the Bank of Upper India it has absorbed the Delhi and London Bank, Limited, which was a small Exchange Bank, the Punjab Banking Company, and the Bank of Rangoon. The Alliance Bank with its head office in Simla now

has 55 branches, which may be classified as follows :—

(1) Branches in the great commercial centres, Bombay, Calcutta, and Rangoon which are useful for remittance and foreign exchange and for utilising funds in financing the movements of crops, because money is wanted at different times in different parts of India ;

(2) Branches in towns in Northern India, including those in the capitals of Native States, such as Gwalior and Bhopal ;

(3) Small branches or sub-agencies which have been opened in a number of small commercial centres, principally in the Native States.

The policy of opening these branches in quite small towns is a very enterprising one which is of the greatest utility to the local trade. The same policy has been followed to some extent by the Allahabad Bank.

I wish to draw special attention to the opening which exists for the extension of small branches or sub-agencies in the small market towns throughout India. In the United Provinces more than half of the head-quarters towns of districts have no bank whatever and the same is true of the Punjab and Central Provinces. In every district there will usually be found two or three local market towns of some importance in which a branch would do very profitable business after two or three years of

development. It is said that it is difficult to obtain properly trained and trustworthy men to act as managers of such branches, except on salaries which are prohibitively high and would make business unprofitable. One cannot help thinking that no attempt has been made to find men of the right stamp and give them training. It would seem that young men drawn from families whose traditional business has been that of private banker would, if given a few years' training in a joint-stock bank, make managers of the right kind with reasonable salaries. They have a hereditary aptitude for such a business, and it is noteworthy that these young men are brought up to a code of honesty and trustworthiness in financial dealings as strict as prevails anywhere in the world.

Along with the above-mentioned promising beginning in the extension of branches of big Joint-Stock banks in small towns, another interesting development is taking place in the conversion of some of the indigenous private banking firms into private banks run on modern lines issuing their cheque forms and having several branches. These two lines of development will probably continue concurrently ; and it is in the general public interest that both should be encouraged as much as possible. At the same time no permanent growth of banking facilities can be established without public confidence ; and this cannot be enlarged and retained unless the business of banking is properly conducted, and adequate cash resources are maintained.

For this purpose all banks, whether Joint-Stock or private, should be required to publish balance-sheets with the detailed information needed for judgment of the bankers' position ; at the least, this should apply to all banking companies and all private banks which issue cheque forms or advertise in newspapers and periodicals.

The internal banking of the country lies, as we have seen, in the hands of the Presidency Banks,* the joint-stock banks and private banks. A special class of banks exists for conducting the finance needed for foreign trade, which are generally termed Exchange Banks. All of these have their head-offices abroad, though there is no reason why this should be the case. The principal exchange banks are those with head-offices in London : the National Bank of India, the Mercantile Bank of India, the Chartered Bank of India, Australia and China, the Eastern Bank, and the new P. and O. Banking Corporation are those which especially devote themselves to Indian trade. There is also the great Hong-Kong and Shanghai Banking Corporation ; whilst several non-British Banks have in recent years opened offices in India with the object of conducting exchange business, such as the Yokohama Specie Bank of Japan, the International Banking Corporation of America, the Comptoir National of France, and others. There is, however, a tendency for more and more banks to enter into

* Recently amalgamated into the Imperial Bank of India.

the exchange business ; which is highly profitable. Banks with their head offices in India, though not primarily Exchange Banks, are doing this—as for example, the Alliance Bank of Simla and the Tata Industrial Bank. Particularly since 1919 others have followed suit by arranging agencies in London and elsewhere.

Some quite recent developments of Indian banking deserve a brief description. The great boom of company promotion of 1919 and 1920, following the termination of the War, included the flotation of many new banks, besides hundreds of industrial companies. Some of these new ventures were obviously unsound from the commencement, particularly those which proposed to enter into some kind of trading as well as banking—a most pernicious combination, because the risks of trade and speculation in commodities are of a nature which banks cannot rightly combine with the duties which they owe to their depositors.

Such ventures are of a class absolutely distinct from what are known as industrial banks. The well-known Industrial Bank of Japan is perhaps the model on which these are founded, though in reality their business is conducted more on the lines adopted by some of the great German Banks. The pioneer in this country was the Tata Industrial Bank. It conducts ordinary banking business and has branches in many places ; but it combines with this special industrial activities which are of two kinds : (1) It assists in the organization and flota-

tion of new industrial companies. It obtains subscriptions for the shares of companies which it approves from its customers and others, and in many cases it underwrites the shares of new companies or of new issues. By underwriting of shares is meant that it enters into a contract with the company itself to subscribe and pay for a certain number of shares of the company should the amount not be taken up by the public when the prospectus is advertised. A commission is charged on the whole amount of shares for which this undertaking is given. If the public does not apply for shares to the extent anticipated the underwriting bank is obliged to take up some proportion of the issue and it then holds the shares, to be sold from time to time to its customers or on the Stock Exchange as circumstances permit. (2) The other industrial business is the financing of private industrial undertakings by grants of loans after a thorough examination of the proposals. Such loans are repayable by instalments spread over five to ten years. Probably only a small part of the capital of the Bank is employed in this business, however, as it is not the best policy in banking business to tie up money in fixed loans of this character. Since the flotation of the Tata Industrial Bank others have been formed, amongst which may be mentioned the Calcutta Industrial Bank.

There has also been a movement for the formation of banks in Native States like Baroda, Mysore and Indore, each State having joint-stock banks

registered under the Companies Acts of those States and accorded certain privileges by the Ruler or the Government of the State.

We may turn now to the most important development of Indian banking of recent times, namely, the passing of an Act in the Imperial Legislative Council to secure the amalgamation of the three Presidency Banks into one great Central Bank for India called the Imperial Bank of India. The movement to establish such a Central Bank has had a long and checkered history. The advantages of a widely extended, State controlled and assisted, bank have appealed to all imaginative thinkers of the past 100 years ; but practical difficulties have always arisen standing in the way of its realization. So far back as 1836 a proposal was made for establishing a Bank for the whole of British India. The suggestion emanated from a body of merchants in London interested in trade with India, but it never got beyond the stage of a somewhat vague prospectus. The Bank of Bengal objected to the scheme, and proposed itself as willing to take over the management of Government business and extend the facilities for banking business in India. Again, in 1859 and 1867 and at frequent intervals thereafter proposals for either amalgamating the Presidency Banks or establishing a separate State Bank for India were put forward. A great and able advocate of this reform was Mr. J. M. Keynes, who devoted part of a chapter to this subject in his *Indian Currency and Finance,* published

in 1913. He wrote a lengthy and detailed memorandum on the subject for the Royal Commission of 1913-14, in which he advocated the establishment of a new and widely extended State Bank which would spring from a union of the three Presidency Banks. The Commission did not commit themselves definitely to this proposal, but desired that it should receive early consideration by a special committee.

The amalgamation of the three Presidency Banks was a complicated matter to negotiate, so many varied interests being involved and so many alternative proposals having been suggested. The Act of 1920 creating the Imperial Bank of India is therefore somewhat complicated and difficult to understand. It will be sufficient to give here an outline of its main provisions—especially those of general public importance and those generally affecting the character of the business to be transacted.

The basis of the amalgamation was that the three Presidency Banks were taken over by the Imperial Bank as going concerns with all their assets and liabilities, their premises and their staff of employees. Even the whole of the Directors of the Presidency Banks were to continue serving as members of the Local Boards of the new bank.

The capital of the new bank is Rs. 11,25,00,000 divided into shares of Rs. 500 each, as compared with a total of Rs. 3,75,00,000 for the three Presidency Banks together. The shareholders of the Presidency

Banks became automatically shareholders in the Imperial Bank, shares of the latter being issued in exchange for the shares held in the former. The increased capital was secured by issuing new shares, the existing shareholders having the right to the allotment of two new shares for every share then held. This was a valuable privilege, as it was expected the shares of the Imperial Bank would rise to a premium ; but, as the shares of the Presidency banks stood at different prices on the stock exchanges before the amalgamation was proposed, it was arranged that the new shares would be allotted on different terms to former share-holders of the different Presidency Banks. The shareholders of the Banks of Bengal and Bombay were entitled to be allotted two new shares Rs. 125 paid for every share held on paying precisely this amount, *i.e.,* Rs. 125 for each share, whilst shareholders of the Bank of Madras were less fortunate and had to pay Rs. 225 for each share issued as only Rs. 125 paid, on account of the lower market value of the shares of the Bank of Madras. The extra Rs. 100 per share, amounting in all to Rs. 15,00,000, went to the Imperial Bank as a premium on the new issue of shares. It is an asset of the new Bank, obtained, so to speak, by discounting the anticipated future increase of value of the shares, and in the balance sheet is included in the " reserve fund " of 372 lakhs which appears on the liabilities side, as representing the permanent excess of assets over liabilities.

A somewhat unusual feature of the Imperial Bank which clearly indicates its origin as an amalgamation, is the provision that in addition to the principal register of share-holders, branch registers shall be kept at the local head offices of the bank in Calcutta, Bombay and Madras. Persons who were share-holders of the Bank of Bengal automatically became share-holders on the branch register kept in Calcutta, and so forth ; and transfers of shares are valid when effected in the branch register in which the shares are registered. Any share-holder may apply to the bank to have any of the shares which he holds transferred from one branch register to another ; but shares may not, of course, be registered in more than one branch register at the same time.

The constitution and governing body of the bank likewise indicate its threefold origin. The annual meeting of the share-holders is to be held in rotation in the towns in which there are local head offices. The business of the bank is to be managed by a Central Board of Governors assisted by Local Boards. The latter were to be at the commencement three in number, consisting as already stated, of the late Directors of the respective Presidency Banks. Other Local Boards may be established from time to time in such towns as the Central Board may decide with the consent of the Governor-General in Council. There is a President and a Vice-President of each Local Board.

The Central Board of Governors, which is

ultimately responsible for the bank's business, is composed in the following manner :—

1. The Presidents and Vice-Presidents of the Local Boards.
2. Not more than four persons nominated by the Governor-General in Council, who hold office for one year, but may be re-nominated.
3. Two Managing Governors to be appointed by the Governor-General in Council on the recommendation of the Central Board, to hold office for such period as the Governor-General in Council may direct.
4. The Controller of Currency or other officer nominated by Government.
5. The Secretaries of the Local Boards.

It is provided, however, that the Controller of Currency, or his substitute, and the Secretaries of the Local Boards, though members of the Board, shall not be entitled to vote. It will be seen therefore that if Government exercises its full powers of appointing Governors there will be twelve voting members of the Central Board, and four non-voting members. When any new Local Board is established, the Central Board will determine how many persons shall be appointed on the Central Board to represent it.

The management of the bank is conducted by the principal salaried officers, who are the two Managing Governors and the three Secretaries.

Managers, Inspectors, and Accountants are appointed as required, and were selected, of course, in the first instance from the existing staffs of the Presidency Banks. It is rather curious that the Act makes no provision for the appointment of a President and Vice-President of the Imperial Bank as a whole. At each meeting of the Central Board the Governors present elect a Chairman from among themselves. Similarly there is no provision made for the location of a general Head Office of the bank. It would appear that the Legislature fought shy of deciding between the claims of the Presidency towns! The Central Board is to meet at least once a year at every local head office.

It was always a feature of the Presidency Banks that they transacted Government business, and that they were limited as to the character of the commercial business they could undertake. The Imperial Bank inherits this privilege and these restrictions. As regards Government business the bank may transact any business with which Government from time to time entrusts it or which is provided for by agreements made between the bank and the Secretary of State. In general the bank acts as banker for Government, and remits money or lends on securities on behalf of Government. It issues Government loans and manages the Public Debt, as the Bank of Bengal used to do. The commercial business which the bank may transact is subject to limitations similar to those which were imposed on the Presidency Banks. They are set

out in great detail in the first schedule to the Act. Generally speaking the bank may not make loans or advances for a longer period than six months, nor upon the security of immovable property (that is mortgages of houses and lands) excepting as collateral security where the original security is either a gilt-edged security or goods which are pledged to the bank. It may not buy or discount bills which do not bear upon them the signatures of two persons or firms unconnected with each other in general partnership ; but this does not prevent the granting of temporary over-drafts to persons who keep regular accounts with the bank.

The bank has an office in London, which is a departure from the traditions of the Presidency Banks ; but this does not mean that it may undertake general business in exchange. It is not permitted to deal directly with the public in foreign exchange, though it may transact business in London on behalf of Government and public bodies, and other banks, and on behalf of certain old customers of the Presidency Banks.

One very important part of the whole scheme of the Imperial Bank is the provision that the bank shall open 100 new branches within five years ; and of these 25 are to be established at places which Government may direct. This ought to do a great deal to improve the banking facilities of the country ; but the Hon'ble Mr. W. M. Hailey, Finance Member, refused to agree to a proposal by the Hon'ble Rai Saheb Seth Nathmal that all the

one hundred new branches should be selected as far as possible in centres of business where there are as yet no banking facilities. He pointed out that a mere multiplication of branches was not the most important work which the Imperial Bank was expected to do. It was to be essentially a bankers' bank ; and as such it could achieve success only by a consolidation of its resources. It must be ready to come to the assistance of private banks in times of stringency ; and in the ordinary routine of the country's banking business it would exercise a useful function by the organization of clearing houses (the operation of which is explained in the next chapter), these being necessary in other centres besides the six towns where they now exist, if private banks are to achieve their full utility.

CHAPTER VIII

INLAND REMITTANCE

As was said in the last chapter, it is possible to save the carrying of money in making payments at distant places by sending currency notes by post. There are, however, many other ways of saving the use of money in making remittances. The system of using *hundis,* which are bills of exchange, or promissory notes, in settling debts between different towns in India, is very ancient. The manner in which it works can be easily explained by an example. Supposing that a merchant in Cawnpore has sold cotton to a merchant in Bombay. He draws a *hundi* for the amount requesting the Bombay purchaser to pay him the amount after sixty days. The form in which the *hundi* is written is not exactly fixed, like the English bill of exchange, but there is a customary wording which is varied but little in individual cases. Some examples are given in the Appendix. The *hundi* is sent along with the railway receipt through a bank or agent to the Bombay merchant to "accept." This he does by writing his name across it, and he then returns it to the drawer. The latter has then two courses open. If he is not in need of the money, he may wait until the end of the month, when he

will send the *hundi* to his agent in Bombay, who on the due date presents it for payment and obtains the money, which he holds for the account of his customer, the original drawer of the *hundi,* or else remits the money to him. It is more likely, however, that the seller of the cotton would be glad to have his money at once. He then sells or "discounts" the bill, taking it to a shroff with whom he does business. This shroff will give him the present value of the *hundi,* that is to say, the amount which at the current rate of interest would, at the end of the month, be equal to the sum for which the *hundi* is drawn. The present value is ascertained by deducting the discount at the current rate, which varies from time to time. The shroff may keep the *hundi* and present it for payment on the due date through his agent in Bombay, or he may take it to a bank where he has an account, and in his turn discount it with the bank. In this case, he must endorse his name on the back, and the bank will then credit his account with the present value of the *hundi.* It is then the business of the bank to collect the amount of the *hundi* when due. If the bank has its head office, or a branch, in Bombay, it collects the *hundi* through that office. If it has no office in Bombay, it must use some other bank as agent. Some banks do a great deal of this business ; but they only deal in *hundis* which have good "names" on them. The law provides that all persons who sign a *hundi* or bill of exchange, whether as drawer, acceptor, or endorser, are

severally liable to pay the sum for which it is accepted to any party who has purchased or discounted it. If either the drawer or acceptor is a firm of exceptionally good standing, that will suffice ; but for most *hundis* the bank requires the endorsement of a shroff of substantial means well known to it. *Hundis* payable on demand have come greatly into use in recent years, and banks undertake the collection of these.

Very similar to the use of demand *hundis* is the system of bank cheques, which is universally adopted in England, and is growing in popularity in India. It is worth while, therefore, to explain in some detail how cheques are used, and how the banks settle through a clearing house all the payments made by cheques.

A man who has deposited money in a bank can write out a cheque, or order to that bank, to pay so much money to some person named. Every bank has its own special form for cheques, which are supplied to every customer who opens an account at the bank. A cheque reads as follows:—

North of India Bank, Ltd.
(Fatehpur Branch)

Pay to *Messrs. Ram Dass & Co.*, or Order,

Rupees One hundred and twenty-two annas eight only.

Ram Gopal Prasad,

Rs. 122-8-0. *Vakil.*

This cheque may be either handed personally to a representative of Messrs. Ram Dass & Co., or sent to them by post. If their business is situated in the same town as the branch of the bank where the drawer, Mr. Ram Gopal Prasad, keeps his account, then Messrs. Ram Dass & Co. can send a clerk to the bank with the cheque after they have endorsed it (signed it on the back), and the bank will then pay out the cash immediately. If, however, Messrs. Ram Dass & Co. have a banking account with another bank in the same town, they will probably find it more convenient to pay this cheque into their own bank with instructions to credit the amount to their account. They have then nothing further to do. Their bank—let us call it "The United Provinces Bank"—sends a peon with the cheque to the branch of the North of India Bank and obtains payment of the money and credits the amount to Messrs. Ram Dass & Co. The North of India Bank at the same time debits the account of the drawer, Mr. Ram Gopal Prasad, with the amount which it has paid out against his cheque.

If the business of Messrs. Ram Dass & Co. had been situated in another town, it would have made no difference, excepting that their bank would have had to claim the amount due from the North of India Bank through the post. The United Provinces Bank would send the cheque, and by return of post they would receive the money in a registered and insured packet. It is worth noticing, however, that in this case there must be an interval

between their receiving the cheque from Ram Dass & Co. and their being certain that the money will be paid to them by the North of India Bank, because it might turn out that Mr. Ram Gopal Prasad had not sufficient money in his account wherewith to pay the cheque. For this reason banks usually do not allow a customer to draw out any large sum against a cheque which has been paid in until it has been "collected."

So far it is not apparent that there is any particular saving of money when remittances are made by cheques. If the transaction we have taken as an example were an isolated case it would be true that all that had happened was that instead of customers sending the money to each other direct, the banks did it for them.

In actual practice, however, single remittances like this are very rarely made by banks. We have taken the case of one customer only; but every well established bank has hundreds of customers dealing with it at every branch. All these customers are frequently paying in cheques which they have received from other persons, and commercial firms pay in many cheques every day. At the same time, these customers will be writing cheques of their own which they are sending to various persons and firms in different parts of the country to make payments. Thus every bank finds that it has, not one, but several cheques drawn by various people on their accounts at a certain bank, and several cheques drawn by other people on accounts

in another bank, and so on. For instance, instead of the United Provinces Bank having only one cheque to collect from the North of India Bank, it probably has 15 or 20. But, at the same time, the North of India Bank finds that it has several cheques to be collected from the United Provinces Bank. Consequently, the system adopted is for each bank to keep deposit accounts with all other banks in the same town. When the United Provinces Bank sends cheques to the North of India Bank, it merely requests that the amount of their total be credited to its account. When the credits of each bank in the other mount up they simply make debit and credit entries for the same amount in their books. Thus bank A will order B to transfer Rs. 10,000 from A.'s credit to itself; and at the same time bank B will give a similar order to A. If there is a considerable excess, it may be withdrawn in cash, or transferred by bankers' draft to some other town. Every bank thus has accounts with the branches of other banks in towns all over the country.

In large commercial cities where there are a great many banks, the business of collecting cheques would be difficult and complicated if carried out in the manner above described. The system has therefore been further elaborated by the establishment of "bankers' clearing houses," where representatives of all the banks meet every day so as to settle the claims which each has against the others. Such clearing houses have been

established in Calcutta, Bombay, Madras, Cawnpore and Rangoon. The clearing houses work upon the principle of reducing the calculations and the transfers of money to the minimum, and this is accomplished by establishing a "common fund" for the clearing house, with which alone each bank has to settle a balance to be received or paid each day. The matter can be made clear if we consider a number of banks and denote each one by a letter. Let there be seven banks with offices in the town, and let these banks be denoted A, B, C, D, E, F, G. We examine the transactions of a single day only, as the clearing operations are entirely completed each day. Bank A has had cheques paid into it by customers drawn on each of the other banks B, C, D, etc., and it has to claim the amounts from each of these banks. Likewise, each of these other banks B, C, D, etc., has certain sums to claim from each of the other banks. The representative of bank A goes to the clearing house with his cheques made up in bundles according to the banks on which they are drawn, with a list of cheques in each bundle. He presents his list of claims on each bank to the representative of that bank. The clerk of every other bank has gone prepared in the same way and presents to each bank his list of claims. Hence, the representative of A gets six lists of cheques claimed from him by the six other banks. Each representative counts the cheques presented and tests the addition of the list. He then adds together the total claims of each of the other six banks and ascertains

the total amount which he has to pay. This he compares with the total sum which he has to claim from all the other six banks. He subtracts the smaller from the larger and finds what sum he has either to pay or to receive on the balance of the whole of the claims. If the balance is against him he has to pay it into the common fund ; if the balance is in his favour, he will receive it from the fund.

Even these payments to and from the common fund are managed without the use of any money whatever. Every one of the banks keeps an account in the office of the Imperial Bank, and there is also an account kept in the Imperial Bank for the Clearing House fund. A bank which is on that day indebted to the common fund simply draws a cheque on its account in the Imperial Bank, and the amount is then credited to the Clearing House account. On the other hand, if the bank has to receive a balance from the common fund, it receives a cheque drawn on that fund which it pays into its account in the Imperial Bank, thereby making the transfer. It will be observed that all the payments into and out of the common fund must balance one another, and that by this simple means all the claims from every bank upon every other bank are adjusted, and without the use of any money at all.

The following figures give the total value of cheques cleared in the principal clearing houses in India in certain years, and they indicate a steady growth in the business of banking, as well as an expansion of trade :—

Total amount of Cheques cleared through Clearing Houses in each year.

(IN CRORES OF RUPEES.)

Year.	Calcutta.	Bombay.	Madras.	Karachi.	Rangoon.	Total.
1900	139	61	12	...	...	212
1905	175	109	16	3	...	303
1910	222	167	21	7	48	465
1915	323	167	19	13	41	563
1918	744	534	25	24	69	1,369
1919	902	758	30	22	88	1,801
1920	1,534	1,394	77	32	108	3,145

Another method of remitting money which is worth mentioning is the "banker's draft." The Imperial Bank and most of the larger Joint-Stock banks issue these on payment of a small commission. Suppose that a man in Lahore has to pay Rs. 2,500 in Calcutta immediately to obtain the dispatch of goods urgently needed. If he sent a cheque this might not be accepted as good, and the recipient of the cheque might wait until it had been collected before he would dispatch the goods, thus causing a delay of four or five days. To obviate this difficulty the man in Lahore can go to any bank and pay down Rs. 2,500 and a small amount for commission, in return for which the bank will give him a draft for Rs. 2,500 made payable to the person whom he indicates. The draft is simply an order to the office of the bank in Calcutta, or to some other bank, to pay that sum of money on demand to the person named. If presented by the right person, or duly endorsed, such a draft is always

instantly paid without question ; consequently, it is as good as ready money, and the merchant will arrange to dispatch the goods immediately he has received it.

It is probably true that the great bulk of payments from place to place which are made without the actual sending of coin or currency notes are settled by means of *hundis,* cheques or bank drafts. These methods, which are very convenient for commercial transactions on an ordinary scale, need to be supplemented by facilities at the two extremes of large and small payments, respectively. For making large payments the Imperial Bank offers facilities as between places where it has branches ; and as regards other places it is possible to purchase " supply bills " and " telegraphic transfers" from Government Treasuries. For small payments, money orders can be sent through the Post Office.

The Government treasuries are of course maintained for the administrative purposes of Government. The revenue collected in every *tahsil* of each district is paid into the sub-treasury, and thence goes into the district treasury. The payments of salaries of Government officers, and other expenditures of Government, are made from the district treasuries ; though where there is a branch of the Imperial Bank it is used instead of a treasury. In accordance with instructions which are issued from time to time by the Accountants General of the provinces, a treasury is allowed to sell to the

public a bill, which is called a " Supply bill " drawn upon any treasury required, provided the latter has sufficient funds. If the sum to be remitted is large a " currency transfer " may be issued, which is payable out of the " Currency Chest ", whilst the supply bill is paid out of the ordinary treasury balance. In either case the purchaser pays in his money at one treasury and the payee, or his agent, draws it out from another treasury. This serves a double purpose. It enables the public, which, in this instance, is mainly banks and large merchants, to transfer money to the place where it is required ; as, for example, when financing the movements of crops, without actually moving coin or notes. On the other hand, it enables Government to transfer balances, which become inconveniently large in many mofussil treasuries, to the larger treasuries in the principal towns. As it takes a few days to send a supply bill by post, and as the immediate transfer of funds is often of commercial importance, Government has arranged for what are called Telegraphic Transfers to be made between the various treasuries. These are simply like telegraphic money orders for large sums (not less than Rs. 10,000), which may be paid for at, and sent from, a Government treasury to another Government treasury where funds are available.

Application must be made beforehand for a supply bill or telegraphic transfer so that the treasury officer who is requested to issue it may obtain authority from the Accountant General of the Province

to do so ; otherwise, there might be difficulty in paying it, or at least the treasury required to pay it might be inconveniently depleted of funds. The commission charged on supply bills and currency transfers is two annas for every Rs. 100 for bills up to Rs. 10,000, and one anna per cent for bills over that sum. As between places where it has branches the Imperial Bank issues supply bills or telegraphic transfers at the same rate of commission, instead of the treasuries, which do not issue them.

The Post Office provides facilities for remitting small sums by money orders through its organization extending over the whole country. It has developed a system of setting off payments in opposite directions against one another, similar in its effect to that which is managed by the cheque and clearing systems of the banks. The manner of operation is of course different, and in many ways simpler, because the post office is a single organization under uniform control ; but the economic effect is the same, namely, that the actual sending of coins or currency notes is avoided. We may see by an example how the system works. On a certain day several persons in Bombay will be remitting sums of money to people in Cawnpore, and on the same day several persons will be sending other sums of money to other persons in Bombay. Every one of these amounts can be delivered to the addressee without any money whatever being sent between Bombay and Cawnpore ; for the money, which is paid in by persons in Bombay, is used to be paid

out to other persons there to whom money has been sent from Cawnpore. If the total sums received at Bombay from Cawnpore exceed the total sums being sent from Bombay to Cawnpore the post-master in Bombay will have to pay out more than he receives, so his available balance of cash will be reduced.

Such payments are always taking place in all directions between different towns, so that Bombay receives remittances of money orders from towns all over India, and is also sending money orders to those towns. As a rule, the amounts which are remitted from and to a town by money order very nearly balance one another. There may be some variation from day to day, but the totals out and in each week very nearly balance.

Seasonal Movements of Funds

The statement at the end of the last paragraph that the total payments made through the post office in and out of a town very nearly balance each week is true as a general rule, but there are some important exceptions. The same statement would be true as a rule of the remittances effected through banks ; but in this case the exceptions are sometimes of great importance. The fact is that there are seasonal variations in the demand for money in different parts of the country, where it is required for financing the movements of crops.

When any commercial crop, that is to say, one which is sold to distant markets, has been gathered in and is ready for despatch, a considerable volume

of money is required for purchasing it from the cultivators and small merchants who are holding stocks. The crops in some parts of India pass through a large number of hands before they reach the godowns of the big exporting merchants in Bombay or other port town. The cultivator sells to the village *bania,* or *mahajan,* and he sells to a grain or cotton dealer in the nearest small market town. The latter sometimes sells to larger merchants in the big upcountry markets, such as Cawnpore, Amritsar, Lyallpur, Indore, etc., and sometimes direct to the Bombay or Calcutta merchants. There is an increasing tendency, however, for the very big commercial firms in Bombay, Karachi and Calcutta, to send their representatives direct to the small market towns, and in some cases even to the villages, so as to purchase from the small merchants, and in the latter case direct from the larger cultivators themselves, thereby cutting out the middlemen's profits. Whichever method is adopted, much money is required to purchase the crop, and as nearly all of this money goes into the hands of the village *banias* and cultivators, it must be paid in the form which they demand. Cheques are useless to them, and in most parts they will not take currency notes ; consequently, it is necessary to send silver. At the time when the cotton crop is being moved from the Deccan, Berar, Khandesh and Northern India to Cawnpore and Bombay, enormous sums totalling many crores of rupees are required in actual silver coin. It is not possible

that so large a quantity of silver should remain in the upcountry treasuries and banks throughout the year. In normal times the silver, which is paid out at the time a crop is brought in, filters back slowly to Government treasuries and banks during the remaining months of the year, as the people are paying their rents and revenue and purchasing cotton cloth, brass utensils, and various other goods. The silver accumulates in the treasuries and branch offices of the banks to an undue extent, and some of it has to be sent to Cawnpore and Bombay and other large industrial centres. When the time comes for the next year's crop to be moved, the merchants take out silver by cashing large cheques at the branches of banks at towns as near as possible to the places where they require it. The banks, therefore, have to move up silver in anticipation of its being required. Supply bills are used so far as available, but many merchants require funds in small market-towns where there is no bank and no treasury, and their usual practice then is to change the currency notes into silver coin at a Government treasury and take the coin in boxes by rail or road to the place where it is required.

It is a feature of the present organization of internal payments in India that actual silver coin is moved from place to place, chiefly by railway, to a far greater extent than in European countries. Coin very frequently has to be moved by Government, and also by the banks. It so happens that the different harvests are ready to be moved at

different times in different parts of India. The cotton crop is moved in December to April in western and northern India ; the wheat crop in April, May and June in northern India ; the Burmah rice crop in January to April, and the jute crop August to December. It will be seen that those banks like the Imperial Bank, or the Alliance Bank, which have their branches widely distributed, can use their funds at one time in financing jute, and another time rice, and then wheat; or cotton may be alternated with wheat. Instead of keeping its silver coin lying idle, the bank prefers to send it by rail many hundreds of miles backwards and forwards between different parts of India during the year.

In the later part of the war period exceptional conditions prevailed ; and the normal return of silver from the hands of the public during the months intervening between the principal commercial harvests did not occur. As explained in a later chapter, the rise in prices led, not only to much larger amounts of silver being paid out to the small merchants, and through them to the cultivators ; but also to the latter hoarding their money with a view to the possibility of prices falling. An enormous absorption of silver resulted, and the difficulties which Government experienced in obtaining silver fast enough and coining it at the mints led to the use of alternative means of payment so far as possible. It was found that in the Punjab the cultivators would accept gold as readily as silver, and sovereigns to the value of many crores of

rupees were paid out in purchasing the wheat harvest. In Bengal an interesting experiment was made in 1918 of purchasing the jute crop with currency notes. It was found that a liberal use of the one-rupee notes along with the ten-rupee notes made this form of payment acceptable to the cultivators of jute, and a great economy of silver resulted.

Economy of Coin

It will not be any great advantage to India if the people at large become habituated to the use of gold as currency in place of silver, for this would mean the employment of vast quantities of the precious metal for a purpose which can be equally well served by paper, either in the form of currency notes, or of cheques and *hundis* used in a more perfectly organized banking system. If a large amount of currency in the form of gold and silver coin is to be used in the country, it can be made available for use only by exporting an equivalent value of goods. Although we mine only a little gold and practically no silver in India, the labour of a large part of the Indian population has to be given indirectly to providing gold and silver. Their labour must be diverted from producing goods for consumption to producing those commodities, which, by exchange, will provide us with the vast quantity of metal required for the currency ; yet the use of the precious metals for currency purposes makes the people no better off. It is used simply to be passed from hand to hand. If all the currency were paper, and

if metal were used only for the subsidiary coins of less than one rupee, we should still be able to purchase things as conveniently as now. If a person wanted gold or silver for making ornaments, he could purchase it in the bazar.

If the labour wasted in obtaining gold and silver for use in circulation were set free from this occupation by a change of our demands, we could direct that labour so as to make the country really wealthier in goods, and ultimately in the enjoyment derived from them. To obtain many crores of rupees worth of gold and silver to be used in currency, we must export goods of that value. We might continue to export those goods, but instead of gold and silver we might buy cloth, machinery and appliances of all kinds, which would help to make Indian labour more productive, and enable the people to live more enjoyably. The moral to be learned from this is, that everybody should do what he can to encourage the use of paper as currency, and to avoid the use of gold and silver. He should insist on being paid in currency notes rather than in rupees ; and if his income justifies it, he should open an account at a bank and make his payments by cheques. Everybody who makes frequent payments finds the use of a bank by far the most convenient arrangement.

CHAPTER IX

FOREIGN EXCHANGE

The system in use for making payments between India and foreign countries is exactly similar in principle to the methods followed for settling payments between places within India. In actual practice there are several ways of making payments between India and England; but most of such payments are made through the agency of exchange banks, as those banks are called which have offices both in India and England. Government also necessarily takes a part in the business, because it has to transfer large sums to London to meet the regular expenditure and interest payments of India in England; and also because at times Government is in a position to give assistance to trade, by providing facilities for transfer of money from England to India, or *vice versa*. Probably about three-fourths of all the payments made in both directions result from trade, that is, sales of goods in either direction. Payments for goods purchased by merchants are generally made by means of bills of exchange.

The Indian exporter having drawn his bill in duplicate, takes it to an Exchange Bank in India where he has an account, and this bank "buys" the

bill, or " discounts " it, crediting his account immediately with the full amount of the bill, less the discount. The bank forwards the bill to its office in London, which presents it for acceptance to the firm on which it is drawn. When the firm which has bought the goods has signed across the bill that it is accepted, it has become a legal undertaking to pay the money on the day when the bill becomes due. When the time has expired the bank receives payment in London. The whole business has resolved itself into two separate transactions: (1) an advance by the bank in India of the value of the goods sold, less the discount, to the Indian exporter; (2) the bank re-imbursing itself by collecting the bill in London when it matures.

The economic result of these transactions is as follows. The Indian exporter gets paid for his goods immediately he has put them on board ship; the English purchaser gets three months' credit from the date when the bill reaches him for acceptance, which is in truth a loan from the bank, as the bank paid the exporter immediately on shipment; and finally the bank gets its loan repaid in London by the bill maturing. Altogether apart from the loan, the bank has rendered the service of enabling the purchaser in England to pay the seller in India for his goods; but the bank's fund of money in India is now reduced by the sum paid to the exporter, whilst the bank's available money in London is increased by the sum received when the bill matures.

The bank obviously cannot go on indefinitely discounting the bills of Indian exporters, or it would soon exhaust its funds in India and transfer all its money to London. This difficulty is surmounted by the fact that the bank also finances imports. The English exporter, who has sold piecegoods or machinery to an Indian importer, draws a bill on the latter and discounts it at the London office of an Exchange Bank. This bill comes to India, is duly accepted and on maturity paid by the Indian importer to the local office of the exchange bank. Many English firms, with a view to limiting their risk, insist upon the payment of cash to the exchange bank for the release of the shipping documents, that is, the bill of lading and invoice and accepted bill, which are held by the bank at the Indian port town, until the Indian importer, having heard that the ship has entered dock, comes with his money and obtains the bill of lading which enables him to claim the goods. If the importer has no immediate prospect of selling the goods, he may not care to use his money in paying for them at once, and he then leaves them to be put into the bank's godown, either in Bombay or Calcutta, or in Cawnpore or Amritsar. The bank then pays the bill of exchange by means of a loan to the importer secured on the goods ; and the latter are taken out when the amount due is paid to the bank.

Whatever the exact method employed, it is obvious that financing the import trade puts the Exchange Banks in funds in India, whilst it at the

same time relieves them of their funds in London. There is also a considerable amount of money sent from India to England in the form of remittances. Persons making large purchases in England or elsewhere must often remit a part of the money with the order; English firms have to remit home their profits and the dividends of companies ; and Englishmen employed in India, and Indians residing in England, are constant remitters of small amounts month by month. The total stream of money so remitted is considerable. The method followed is for the remitter to buy a bill from one of the exchange banks either directly or through an upcountry joint-stock bank where he has an account. This bill is posted to London and can be collected by any English bank from the office of the Exchange Bank. Of recent years a large proportion of such private remittances have been made by telegraph; but the effect is always the same. The remitter pays money to the exchange bank in India, and the money is paid out in London. We see therefore that the financing of imports by bills, and the stream of remittances to London, are the chief sources whereby the Exchange Banks provide themselves with funds for financing export bills.

The Balance of Payments

It has just been explained that Indian merchants who export goods draw bills of exchange on the buyers of those goods in England, America, or elsewhere; and likewise, the sellers of goods which Indian merchants are importing, draw bills upon

the latter, which they sell to the banks in their own countries. These banks set bills in one direction off against the bills and remittances in the other direction; and obviously, when these payments in opposite directions balance one another, there is no need for the Exchange Banks to remit money at all. It very often happens, however, that when all payments in each direction are thus set off against one another, there remains a balance of payments to be made in one direction or the other. In normal years, the balance of payments is "in favour of India," which means that there is a balance of money due to be sent to India, because the exports are of greater total money value than the total value of the imports added to the interest charges on private capital and other money remittances due from India. Consequently the banks, after setting off payments in each direction against one another, find that they must send a balance of money to India. This they can do by sending gold or silver, the latter being sold at its market price; but often the actual shipment of coin or bullion is unnecessary. As Government requires to remit money to London to meet the Home charges, which amount to about £30,000,000 per annum (over 45 crores of rupees), this is done by the Secretary of State selling in London what are called Council Bills. A bank in London having a balance of payments which must be remitted in money to India, buys a Council Bill from the Secretary of State entitling it to receive so many thousands of rupees from the Government

Treasury in Bombay, Calcutta or Madras. This being posted to India and cashed settles the balance of payments so far as that Bank is concerned.

In like manner, when the balance of payments is against India—that is to say, if more money is owing from India to other countries than from those countries to India—it is necessary either to send gold or silver out of India, or to buy from the Government in India bills payable in London, which are called "Reverse Councils," or "sterling bills." These bills are paid for in rupees at Government Treasuries in India ; and when sent to London they entitle the holder to be paid so many thousands of pounds English money out of the balances of the Secretary of State.

The sending of Council Bills by post takes time, however, and Government has in recent years given great facilities for the remittance of what are called "Cable Transfers" or Telegraphic Transfers, which may be sent in either direction between London and one of the Presidency towns in India. Government now sells both "immediate" and "deferred" telegraphic transfers between England and India, the former being sent immediately, and the latter 16 days after they are paid for. The price of "deferred" transfers differs from the price of "immediate" transfers by 1-16*d.* per rupee, the "deferred" transfers being cheaper by that amount, so as to compensate for loss of interest on the money for 16 days. The public do not usually buy Council Bills or telegraphic transfers direct

from Government. The Exchange Banks (see above, pp. 73-74) make this a part of their business ; and any person in India wishing to remit, say, £200 (about Rs. 3,000) to England by telegraph, simply writes an order to that effect to his usual bank, which, if not itself an Exchange Bank, passes on the order to the Exchange Bank for which it acts as agent, and charges a very small commission.

The Rate of Exchange

There is one point about the making of foreign payments, which it is necessary to understand ; and that is the effect which the fact of there being a balance of payments due in one direction or the other may, in certain circumstances, have upon the rate of exchange. Supposing that there is a large balance of payments due to India, this balance can be adjusted by the sending of gold from London, or by the sending of Government promissory notes, or any saleable securities, to India ; or by purchasing Council bills, which the Secretary of State, before the war, was prepared to sell without limit at 1*s.* 4$\frac{1}{16}$*d.* Persons desiring to send money to India would naturally compete among themselves to buy these bills, and would, in order to get more bills than their competitors, offer a higher rate; but, of course, they could get any quantity at 1*s.* 4$\frac{1}{16}$*d.* This latter figure was, therefore, the limit, beyond which exchange could not rise. On the other hand, when the balance of payments was from India outwards, either gold had to be obtained from the Government reserve, or in the market, for export, or traders had

to apply to Government for Reverse Councils. Before the war these were sold at 1*s.* $3\frac{29}{32}d.$ Between 1*s.* $4\frac{1}{32}d.$ and 1*s.* $3\frac{29}{32}d.$ fluctuations in exchange were possible.

In normal times the exchange rates between any two countries having the gold standard can fluctuate only between narrow limits, which are determined by the cost of shipping gold in either direction. These limiting rates are termed the "upper" and "lower" *gold points,* or "inward" and "outward" gold points. For example, the par of exchange between London and New York is $4.866 for £1. The "inward" gold point, speaking from the English point of view, is $4.90, whilst the "outward" gold point is about $4.83. This implies that the cost of shipping gold either way between London and New York is approximately $0.035, or $3\frac{1}{2}$ cents per £1. The par of exchange $4.866 represents the price in New York of £1 in England, and the cost of sending gold would necessarily have to be added to this, so that exchange cannot rise above about $4.90, because at that point a stream of gold begins to be sent from New York to London. Conversely, when exchange falls to $4.83, London is paying a high price for the dollar, and it becomes remunerative to send gold to New York.

In precisely the same way, as regards the Indian sterling exchange, the inward gold point was, from India's point of view, before the war, 1*s.* $4\frac{1}{32}d.$, and the outward gold point 1*s.* $3\frac{29}{32}d.$ Since the alteration of the rating of the rupee in February, 1920,

to a parity of 2*s.*, the theoretical inward gold point is 2*s.* $0\frac{1}{4}d.$ and outward gold point 1*s.* $11\frac{2}{3}\frac{5}{2}d.$ The increase of the margin of variation from the par of exchange from $\frac{1}{8}d.$ to $\frac{1}{4}d.$ in the case of the inward gold point, and correspondingly for the outward point, is partly apparent and partly real. In the first place, it must be remembered that the sovereign is now legally worth Rs. 10 only instead of Rs. 15. Consequently, the proportional cost of shipping the sovereign added to the price of the rupee is correspondingly increased. The real increase of cost is due to the higher level of freight rates which have prevailed since the war.

It is necessary now to understand what happens to the exchange rate in abnormal times, when gold and silver are not available for shipment. For simplicity sake, let us first of all take a purely hypothetical case relating to the Indian exchange. We may suppose that there is a large balance of payments due to India, and that it is impossible to buy sufficient gold and silver for shipment to India to settle the balance, and that Government cannot offer Council bills sufficient to satisfy the demand. How then can the balance be paid? In fact it cannot be paid under those circumstances. People would then try to export either valuable goods, such as precious stones, or Government promissory notes, or other securities, to settle the difference. If these, as well as money, were not available for remittance at profitable prices, then there would indeed be no way of sending the balance due, and the people

desiring to send the money would compete amongst themselves to buy bills entitling them to receive money in India. This would naturally cause the price in London of every rupee in India to rise ; and so the rate of exchange would be likely to rise much above gold point. There is in fact no definite limit to the height to which it might rise under those circumstances. On the other hand, if the balance of payments were from India outwards, and if there were not enough gold obtainable in India for export, and if Government were unable to sell Reverse Councils sufficient to meet the demand, persons having to make remittances to London would compete with one another ; and the price of £1 in London would rise, and the exchange rate, therefore, would fall, below the outward gold point. The price of £1 in London would then have risen, before the war, from Rs. 15 to Rs. 16, or more, which means a fall of the rate of exchange, as usually quoted, from 1*s.* 4*d.* to 1*s.* 3*d.*, or lower.

Thus, we see that the maintenance of the rate of foreign exchange at a figure close to the par of exchange is dependent upon there being available some means of making payment of the balance due in one direction or the other. If the balance of indebtedness cannot be paid, the exchange rate will tend to rise or fall beyond gold point, according to whether the balance is in favour of or against India.

The only limit to such movements of exchange is the compensatory action which the high, or low, exchange itself has on the current of trade. When

exchange rises high, some people having to make payments to India expressed in rupees find that it has become expensive to make such payments, and arrange to postpone them. Indian exporters selling abroad in prices expressed in English money find that the rise of exchange makes it impossible for them to sell at the former prices because the English price becomes converted into a smaller number of rupees. When they raise their prices, however, some of the business is lost, the prices being too high for foreign buyers. Consequently the export trade tends to diminish. In that way, the balance of payments due to India gradually becomes reduced until it disappears, and payments inwards and outwards become equal. This result has followed, however, only *because the exchange rate has risen.*

In a similar manner, a heavy fall of the exchange rate, due to a large outward balance of payments tends to correct itself. When the exchange rate is lower, the rupee buys fewer shillings and pence English money, and so the cost of purchasing goods for import to India increases. With a heavy fall of exchange, the cost of many kinds of goods would become so high that the demand for them in India would fall off considerably. It is important to notice that such a reduction of the import trade is usually accompanied by an expansion of the export trade, which is stimulated by a low rate of exchange. The effect of a fall of exchange is, therefore, automatically to bring into operation forces

tending to reduce imports and increase exports. This tends to restore equality in the payments due outwards and inwards.

Considerable movements of the exchange rate resulting from the causes just described can be illustrated best from the experiences of Europe in the period since the termination of the war. The exchange rates between various countries of Europe and between America and Europe have risen or fallen a long way from the par of exchange and have been undergoing violent fluctuations. The situation in regard to the European exchanges will be understood by studying the table opposite which gives the exchange rates between London and many countries of the world. The first column of figures gives the par of exchange for each country, and the other columns the actual quotations on the dates stated. It will be seen that the Italian *lira* and the German *mark* were heavily depreciated in February, 1920, the mark, in particular, being worth only one-sixteenth of its par value in gold.

These fluctuations of the exchanges are obviously very unsatisfactory and embarrassing to merchants, as they cannot form any estimate beforehand as to what the probable movements of exchange will be. If they could do so, they would adjust their prices accordingly; but the only course open to a merchant is to make a long term contract in advance for exchange, so that at the time of purchasing goods for sale abroad, or *vice versa,* he may cover his transaction by having the exchange purchased in advance.

It is very useful that the exchange banks make such arrangements; but, as it is a risky business for them, the rate of exchange offered is necessarily unfavorable to the trader.

The influence of an excessive balance of payments on the Indian exchange has not in the past been considerable—at any rate, it has been small in comparison with what has happened as between other countries. Government has always made provision, so far as proved practicable for facilitating the remittance of a balance of payments. During the war, when there was a very favourable balance of trade and a difficulty in obtaining funds to finance exports from India, exchange would undoubtedly have risen higher than the rate at which Government were prepared to sell Council bills, had not a certain measure of control been exercised.

Table of Exchange Quotations in London.

—	Unit.	Par of Exchange.	Market Quotations.		
			12th Sept. 1919.	27th Feb. 1920.	24th June 1921.
America ...	Dollars per £	4·867	4·165	3·39	3·736
France ...	Francs „	25·225	35·50	48·35	46·72
Italy ...	Lire „	25·225	40·70	62·375	78·67
Germany ...	Marks „	20·43	109·00	337·5	269·00
India ...	Price of Rupee...	1*s.*4*d.*	1*s.*10*d.*	...	...
		2*s.*0*d.*	...	2*s.*7¼*d.*	1*s.*3⅝*d.*
China (Shanghai)	Tael ...	2*s.*6½*d.*	6*s.*0*d.*	8*s.*4*d.*	3*s.* 6*d.*
Japan ...	Yen ...	2*s.*0½*d.*	2*s.*5½*d*	2*s.*9¾*d.*	2*s.*6¾*d.*
Argentine ... (South America)...	Peso ...	47·6*d.*	55⅝*d.*	69¾*d.*	44½*d.*

At that time gold was not available for export from England, and the Government of India experienced difficulty in providing funds in India, by the purchase of silver and otherwise, to an extent sufficient to allow the Secretary of State to sell Council bills to meet the full demand of the Indian export trade. It was, therefore, made a condition of the sale of Council drafts in London during the war that the rupees so provided in India should be used solely for the purpose of financing the export of commodities required for the prosecution of the war. In this way, the exchange rate was prevented from rising above 1*s.* 4¼*d.*, as it must have done in the prevailing circumstances of trade if there had been no conditions imposed. The subsequent increases to 1*s.* 5*d.* and 1*s.* 6*d.* were necessitated by the rise of the price of silver, as will be explained later in Chapter XIII ; but such increases were rendered possible, and indeed easy, by the balance of payments being strongly favourable to India.

The effect of a highly unfavourable balance of payments on the Indian exchange may be illustrated by the conditions prevailing in the year 1920. A demand for Reverse Councils arose in January of that year when exchange was standing at 2*s.* 4*d.*; and month by month the demand for Reverse Councils grew until it reached unprecedented proportions. This was due mainly to the fact that, whilst the total value of exports remained stationary, the imports were gradually increasing in value, partly owing to the compensatory effect of the rise of

exchange, which has been already alluded to above (page 112), partly because the shortage of stocks of goods of many kinds due to the war was being made good ; and partly because a boom in company promotion had led to the ordering of a great amount of machinery and plant from abroad. Added to the growth of payments for imports, was an unusually large stream of remittances of profits and savings of persons who were tempted by the unusually high rate of exchange to make a profitable investment of their money in England. Reverse Councils were sold to the amount of £11-million in February, and thereafter at the rate of £1-million per week ; but this was quite insufficient to meet the unfavourable balance of payments. The result was that the market rate of exchange fell much below the rate at which Reverse Councils were sold, which was calculated at the theoretical gold parity. By the middle of June the market rate had fallen to 7*d.* below the rate for Reverse Councils, and towards the middle of the month exchange touched its lowest point, namely, 1*s.* 8*d.* Of course, exchange would not have fallen so low if there had been in India a large quantity of gold available for export. In this respect the situation was peculiar, and, as explained in a later chapter, large imports of gold were being made by Government. It was not possible to release gold for export at a price corresponding with the exchange rate of 2*s.*, at which Reverse Councils were being sold ; and the internal price of gold was such that it was not profitable to export gold obtained

from the banks or the bazars when exchange was at any point above 1*s.* 9*d.* The unfavourable balance of payments was able to exercise its full effect in depressing the rate of exchange after the suspension of the sale of Reverse Councils at the end of September, 1920, and the rate fell gradually below 1*s.* 4*d.*, and remained fluctuating about that level throughout 1921. The course of events will be more fully described and explained in Chapter XV.

CHAPTER X

THE FALL OF THE PRICE OF SILVER

The present position of the Indian currency system cannot be fully understood without a knowledge of its past developments. In Chapter III we traced the conversion of the English currency from the double standard of gold and silver to the gold standard with a token currency of silver, and the change in India from the double gold and silver standard to the single silver standard. The present chapter is devoted to the period 1835 to 1893, the outstanding feature of which was the fall of the price of silver. We shall also see what were the causes of the changes which took place during that period, and examine their results.

From 1835 onwards to about 1872, there was little alteration in the currencies of Europe and India. For many centuries the ratio of exchange between gold and silver had been approximately 15 tolas of silver to 1 tola of gold ; which corresponds with the price of 62$\frac{1}{2}$*d.* per ounce for standard silver in London. Sometimes the ratio rose to 16 : 1 (that is, 58$\frac{7}{8}$*d.* per ounce) as in 1845 ; and sometimes it fell nearly to 14$\frac{1}{2}$: 1 (65*d.* per ounce) as in 1859 ; but there was never any great change. On the whole, however, the price of silver was higher during the years from 1851 to 1866 than it

had been previously for any such lengthy period. The reason of this is probably to be found in the great increase of the world's production of gold which began in 1851 as the result of the discovery and exploitation of the new goldfields in California and Australia. The gradual increase of the supplies of gold facilitated an extension of credit by banks in England, and tended in this way to raise the price of commodities, and with them the price of silver. It is indeed surprising that the price of silver did not rise higher. The explanation is probably to be found in the fact that the famous French Law of 1803, which established the double standard, and made both silver and gold standard money at the ratio of $15\frac{1}{2}$: 1, was still in operation. Gold tended, therefore, to replace silver in France as the circulating medium because the fall in the price of gold relatively to silver had made it the cheaper metal. This meant that large stocks of silver were going on the market from France, and this tended to keep down the price. From 1865 onwards, the world's production of silver began to increase considerably ; and the effect of this in lowering its price could not be long delayed.

During 1872, however, the rate of exchange between England and India was fairly stable and varied round about 2*s.*, usually just a little under. The exchange rate varied, of course, with the price of silver ; but the range of variation was small compared with what happened afterwards. In order to understand exactly what the position

was at this time, we may make a calculation of what the rate of sterling exchange must have been during this period. The sovereign contains almost exactly 113 grains of pure gold, and the rupee, which weighs 180 grains, contains 165 grains of pure silver. When the market price of silver corresponded with the ratio of 15 tolas of silver equal to 1 tola of gold, the number of rupees which it cost to buy £1 in London is found by the following calculation :—

$\frac{113}{165} \times 15 = \frac{1695}{165} = 10{\cdot}27$, or nearly Rs. 10-4-4.

That is to say, the price of the sovereign was Rs. 10-4-0, and the rate of exchange, as usually expressed, namely, the price in London of buying one rupee in Bombay or Calcutta, was $20s. \div 10{\cdot}27$ or about $1s.\ 11\frac{1}{2}d.$ When the ratio of silver to gold altered to $14\frac{1}{2} : 1$, the equivalent rate of exchange was $2s.\ 0\frac{1}{4}d.$; but the ratio usually varied between $1s.\ 11d.$ and $2s.$ The rates of exchange thus calculated are equivalent to the par of exchange as the term is understood between two countries both having the gold standard, or both the silver standard. Obviously there is no fixed par of exchange between a country with a gold standard and a country having a silver standard. The ' par of exchange ' is then a variable figure depending upon the world's price of silver in terms of gold ; and it is calculated as shown above. The balance of trade has its effect upon the rate of exchange at the same time. When the balance of payments was in favour of India, as was usually the case, the rate of exchange would rise above the parity of the price of silver to the extent of

about $\frac{1}{2}d.$, which represented the cost of importing silver. On the other hand, when the balance of payments was outward, the rate of exchange would fall to nearly $\frac{1}{2}d.$ below the parity of the price of silver.

It was in 1872 that the radical change in the relations of silver and gold began. In the previous year Germany had decided to begin a reform of her currency on the basis of adopting the gold standard. The convenience of the English system, and the advantage to trade of a fixed exchange with the gold using countries, then principally the British Empire, were recognised and were probably the chief reasons. In 1872 Germany began to export large quantities of silver coin and imported gold. Several of the smaller countries of Europe followed the example of Germany, so that by 1873 much redundant coin was in the market, and France found that the operation of her fixed bi-metallic standard at the ratio of $15\frac{1}{2} : 1$ was leading to the export of her gold coin and the import of silver. Early in 1874, therefore, France, and later the other countries of the Latin Monetary Union—Belgium, Italy and Switzerland—suspended the free coinage of silver. In course of time the silver five-franc piece acquired a scarcity value, and when France adopted the gold standard, it was declared a token coin, representing the fourth part of the gold twenty-franc piece. From this date, 1874, a rapid fall of the price of silver set in, and continued for nearly twenty years, with short periods of recovery.

There appear to have been many causes which combined to achieve this result. The general opinion is that, not only was silver becoming more plentiful in relation to the demand, but gold at the same time was becoming more scarce, or appreciating in value. These causes may be taken separately.

In the case of silver, two factors were affecting the supply. In the early years of the fall of the price, much redundant silver coinage was coming on the market from those countries which had adopted the gold standard. At the same time the world's production of silver was continually increasing, and the cost of production of silver was declining, partly owing to the discovery of new mines ; but mainly owing to the invention of the Pattinson process for separating silver from lead, which made it profitable to extract comparatively small quantities of silver which in previous times would have been left in the lead as sent to market. It even became profitable to take the lead roofs off large buildings in Europe and to replace them with new lead, merely in order to extract the silver from the old lead. Thus there was a great increase of the supply of silver. On the other hand, the demand for silver was reduced by the fact that for many years very little was required in Europe or America for coinage purposes. The demand of India and China still remained; but this was not sufficient to support the price.

A large share in causing the fall of the price of silver must be attributed to the appreciation of gold.

The general purchasing power of gold was rising, as indicated by the fall in the general level of prices in many countries about this time. In England and Germany the decline commenced in 1873, whilst in America it had started in 1865, soon after the end of the Civil War. In all the countries which had adopted the gold standard a decline of prices set in. This was due to the greatly increased demand for gold as currency, combined with a decline in the world's production of gold. The richest beds of the Australian and Californian gold-fields had been exhausted ; and the South African and Klondyke gold-fields had not been discovered. Trade was expanding rapidly in the seventies ; and as will be explained in the chapter on Prices (Chapter XVII), if the currency and " bank money " in a country remains constant in total amount, and the rapidity of circulation is unchanged, but the volume of trade increases, prices must fall. It may be asked why credit money, particularly the so-called bank money, which is a substitute for currency, did not increase as rapidly as the growth of trade, and thus tend to keep prices steady. The reason is probably to be found in the fact that the banker requires a certain percentage of gold for his reserve ; so, if the basis of his loans, namely, gold, was becoming scarcer relatively to the volume of trade so must the credit money also, which is based on gold. Furthermore, as a result of a series of commercial crises and panics, culminating in those of 1857 and 1866, the English banks had learned to be more cautious as to

the nature and extent of their loans. They henceforth followed a policy of extreme caution, which tended gradually to contract the volume of credit relatively to the total volume of trade.

On referring to the table and diagram (Chapter XVI, pp. 269-270), it will be seen that prices in England fell from a level of 111 in 1873 to 62 in 1895—a fall of 45 per cent. In a similar period, from 1871 to 1894, the price of silver fell from 60½*d.* to 29*d.*, that is, by 52 per cent. It may be fairly inferred that the special causes affecting the demand for and supply of silver merely accentuated the fall of the price, which must have taken place as part of the general fall of prices, due to the appreciation of the value of gold.

It is important now to examine the effects upon India of the fall of the price of silver. The first and most obvious effect was the fall of the exchange rate. At the beginning of this chapter, it was explained that the parity of exchange between two countries, one having the gold standard, the other the silver standard, must rise and fall in accordance with the price of silver in the world's market. London is the great silver market of the world, and the price of standard silver in London is the figure generally quoted as representing roughly the price in all the principal countries. It will be apparent how closely the rate of exchange depended on the average price of silver by examining the following table, which gives the price of silver in pence per ounce Troy in London, and the average rate of

sterling exchange in the same year :—

Year.	Exchange.		Price of silver.
	s.	*d.*	*d.*
1863-64	1	$11\frac{7}{8}$	$61\frac{3}{8}$
1867-68	1	$11\frac{1}{8}$	$60\frac{1}{2}$
1871-72	1	$11\frac{1}{8}$	$60\frac{1}{2}$
1875-76	1	$9\frac{5}{8}$	$56\frac{3}{4}$
1879-80	1	8	$51\frac{1}{4}$
1883-84	1	$7\frac{1}{2}$	$50\frac{1}{2}$
1887-88	1	$4\frac{7}{8}$	$44\frac{5}{8}$
1888-89	1	$4\frac{3}{8}$	$42\frac{7}{8}$
1890-91	1	$6\frac{3}{8}$	$47\frac{11}{16}$
1891-92	1	$4\frac{3}{4}$	45
1892-93	1	3	39
1893-94	1	$2\frac{1}{2}$	$35\frac{5}{16}$
1894-95	1	$1\frac{3}{8}$	$28\frac{15}{16}$
1895-96	1	$1\frac{1}{2}$	30
1896-97	1	$2\frac{1}{2}$	$30\frac{3}{4}$
1897-98	1	$3\frac{3}{8}$	$27\frac{9}{16}$
1898-99	1	4	27

It will be seen that the price of silver remained above 60*d.* per ounce till 1871-72, but that by 1875-76 it had fallen to $56\frac{3}{4}d.$ At the same time exchange, which had been uniformly just a trifle below 2*s.* fell to 1*s.* $9\frac{5}{8}d.$ Looking down the table, it will be seen that, as the price of silver continued to fall, so did the rate of exchange. In 1890, however, the price of silver rose rapidly for a time, owing to the operation of the Sherman Act in the United States, which required that Government every year to purchase 54 million ounces of silver. In 1890-91 exchange varied between 1*s.* 9*d.* and 1*s.* 5*d.* Thereafter, however, the downward course in the price of silver and

of exchange continued with little interruption. In 1892-93 the rate of exchange had fallen to 1*s.* 3*d.* and the price of silver had fallen to 39*d.* and was still tending downwards.

The effects within India itself were those which would naturally be expected in a silver standard country when the price of silver was falling in the gold standard countries. Great quantities of silver were imported into India to settle the favourable balance of trade, and this silver was very largely converted into rupees, because the mints were open to the unlimited coinage of silver. There was thus a considerable increase of the rupee circulation, and at the same time some increase of the paper currency. The result was an intermittent but general rise of prices in India during the latter part of the period, namely 1883-1897. This was particularly evident in the prices of foodstuffs and of other commodities produced and consumed within the country, and the rise of prices was reflected in the rise of wages. On the other hand, the prices of commodities imported from abroad, and of raw material exported, mostly tended to fall slightly in price, or remained stationary.

The price of silver in India was, of course, a fixed figure, namely Rs. 106-6-0 per 100 tolas of pure silver. India having then the silver standard, this price of silver was what is called the mint par. It is a mere statement in another form of the proportion of pure silver in the rupee with a deduction for the cost of coining. As the rupee, which weighs

1 tola, is eleven-twelfths pure silver, the number of rupees which are equivalent to 100 tolas pure silver is :—

$$\frac{12}{11} \times 100 = \text{Rs. } 109\text{-}1\text{-}6.$$

If we deduct Rs. 2-6-3 as the charge (at 2.2 per cent) made by the mint for the coinage of 109 silver rupees, and annas 5-3 for the loss of interest whilst the silver is undergoing assay and coinage, and the cost of transportation, etc., this gives us Rs. 106-6-0 the fixed price of 100 tolas of silver in terms of rupees. In gold standard countries, there is, of course, a fixed price of gold in normal times, which in England is £3 17*s.* 10½*d.* per ounce.

The effect of a fall of the rate of exchange on Indian foreign trade is not easy to ascertain. At first sight, one would suppose on theoretical grounds that a falling rate of exchange would greatly benefit the export trade and at the same time depress the import trade. The actual statistics of the value of foreign trade during the period in question do not support this view, however. Expansion of trade went on during the short periods when exchange was stationary or rising slightly, and there was no great expansion of export trade during the short periods when exchange fell rapidly. It is to be remembered that prices in the gold standard countries were falling at the same time ; and very often the fall of the prices of Indian raw produce in foreign markets coincided very closely with the fall of the rate of exchange. Whilst the fall of the exchange rate does not seem to have done much to stimulate the growth

of the export trade and of industries producing for export, it certainly at times provided great profits in the export trade.

Exporting merchants, who were buying things in India in rupees, were selling them in London and elsewhere in pounds sterling, or in the gold currency of some other country, and they were often getting unexpectedly high prices for their goods when the gold prices were converted into rupees. This doubtless contributed to building up the big fortunes of the merchant princes of Bombay and Calcutta, which were used to finance the development of the trade of the country, and in expanding the cotton and jute manufacturing industries.

Allowing about three years as the probable time before the profits of trade would become invested in cotton and jute mills completed and at work, we may take the following figures as indicating the growth of these industries as a result of capital invested during the period of falling exchange :—

——	1878-79.	1898-99.	Percentage Increase.
Cotton Manufacture.—			
Number of Mills ...	58	174	200
Number of Looms ...	12,983	37,288	187
Number of Spindles ...	1,436,464	4,463,342	211
Authorised capital (in lakhs of rupees).*	571	1,504	163
Jute Manufacture.—			
Number of Mills ...	22	33	50
Number of Looms ...	4,946	13,421	172
Number of Spindles ...	70,840	279,482	294
Authorised capital (in lakhs of rupees).	267	493	85

* Sterling share capital is converted at Rs. 10=£1.

The Government, on the other hand, suffered considerable loss through the depreciation of the rupee, because it had undertaken heavy expenditure in London, which had to be met every year. This expenditure was very largely interest upon monies borrowed in London for use in India. It included the cost of plant and materials for railways and irrigation works, the maintenance of the office of the Secretary of State in London, the pensions of retired officers of the Indian services living in England, the cost of purchase of stores, and many other items. The rupee having fallen in value from 2*s.* to 1*s.* 3*d.*, it is obvious that to purchase every £1,000 in England required a correspondingly greater number of rupees—Rs. 16,000 instead of Rs. 10,000. The difficulties with which the Government of India was faced owing to the fall of exchange were clearly stated by the Indian Currency Committee of 1893. "In 1873-74," they say, "before the fall commenced, the amount remitted was £13,285,678, which, at the rate of exchange of 1*s.* 10.351*d.*, was represented by Rs. 14,26,57,000. During last year (1892-93) the amount remitted was £16,532,215, which, at the average rate of exchange in that year, *viz.*, 1*s.* 2.985*d.*, required a payment of Rs. 26,47,84,150. If this could have been remitted at the exchange of 1873-74, it would have needed only Rs. 17,75,19,200."

The Government of India had therefore to remit in 1892-93 Rs. 870 lakhs more than if the exchange had remained at the level of 1873-74, and Rs. 980 lakhs more than would have been necessary at the

old exchange rate of 2*s*. To those familiar with the public finance of India at the present time, a loss of Rs. 870 lakhs over a series of years may not seem a very serious matter ; but it has to be remembered that in 1892-93 the whole revenue of India was only Rs. 90 crores, whilst the estimated revenue for 1920-21 is more than twice as great, namely, Rs. 205 crores. Consequently the loss of that sum was far more serious then than it would be at the present time.

Much difficulty was found in making up the deficit resulting from the loss on exchange, the only means of doing so being the imposition of additional taxation. The Government of India had to face the possibility of exchange falling still further with a further fall of the price of silver. They had to examine what would be the position of Indian finance if exchange fell to 1*s*. As Sir David Barbour said in his financial statement of 1893. "Our financial position for the coming year is at the mercy of exchange, and of those who have it in their power to affect in any way the price of silver. If we budget for the present deficit of Rs. 1,59,51,000, and exchange rises one penny, we shall have a surplus ; if it falls a penny, we shall have a deficit of more than 3 crores ; if we impose taxation to the extent of Rs. 1½ crores, a turn of the wheel may require us to impose further taxation of not less magnitude ; another turn, and we may find that no taxation at all was required. It will be obvious, from what I have just said, that what we have got to consider in

making our arrangements for the next year, is not so much the question of increasing the public revenue, or restricting that portion of the public expenditure which is under our control, but the chances of a settlement of the currency question."

It will be easily understood, therefore, how urgent was the question of currency and exchange at that time. Not only was Government losing heavily, but the merchant community was suffering badly from the instability of exchange which turned every trade operation into a gamble in the fluctuations of exchange. There is no wonder, therefore, that the period from 1874 to 1893 was one of continual controversy on the currency question. The output of literature, official and non-official, was enormous. Other countries were similarly affected in different ways according to their various circumstances, and in every country the currency question was a source of raging controversy and political propaganda. In the United States of America, there were repeated proposals to revert to the silver standard ; but the alternative proposals of attempting to stabilise the price of silver were adopted and resulted in the Sherman Act above mentioned. The most controversial of the proposals was that known as bimetallism, the object of which was to secure an international agreement amongst all the principal countries of the world to fix a standard ratio between gold and silver. It was held by this school that the double standard, if universally adopted, would be successful and beneficial and they pointed to the

success of France and the Latin Union in maintaining the double standard at the ratio of 15½ : 1 for sixty years. A series of international monetary conferences was held, the first being in Paris in 1878. There were four such conferences altogether, but no success was achieved in securing agreement between the principal countries as to the ratio to be adopted between gold and silver and the method of bringing the change into effect. The question was all the time being complicated by the further fall of the price of silver.

The Government of India and a strong party of public opinion in India favoured the proposed bi-metallic system. India was represented at these international conferences, and Government delayed making any decisive change in the Indian currency system in the hope that the conferences would lead to a successful solution of the problem. The failure of the last International Monetary Conference held at Brussels in 1892 convinced Government that they had nothing to hope from bi-metallism, and that India must take action by herself on whatever lines seemed most likely to meet her special conditions. Even before the Brussels Conference met, Government had appointed a Committee on the Indian currency, of which Lord Herschell was the chairman to examine the situation and certain proposals of the Government of India, and to report in the light of the results of the Brussels Conference. As we shall see in the next chapter, this Committee proposed the closing of the Indian Mints to the

unlimited coinage of silver, and this measure was immediately adopted by Government, thus introducing the next stage in the currency history of India—the adoption of the Gold Exchange Standard.

CHAPTER XI

THE GOLD EXCHANGE STANDARD

The continued fall of the price of silver involved the fall of the rate of exchange with it, as we saw in the last chapter. Government was suffering heavy loss in the remittance of money to London to meet the Home charges, and the foreign trade of India was suffering from its speculative nature owing to the instability of exchange. We have seen that the seriousness of the position led Government to appoint a Committee under the Chairmanship of Lord Herschell in 1892. The question put to the Committee was whether the Government of India should be allowed to carry into effect the proposals which they had just made for stopping the unlimited coinage of silver in India with a view to the introduction of a gold standard ; and what modifications, if any, they might suggest.

The Committee issued its report in the following year ; and it has become a classic document in the history of the Indian currency. They examined the effect of the fall in exchange on Indian finance and on the people of India and its commerce ; and they fully concurred with the Government of India in the need for a change in the currency system. The Committee agreed that the mints should be closed to the unlimited coinage of rupees for the public ;

but they suggested that Government should announce that it would continue to coin rupees and issue them to the public if required in exchange for gold at a ratio to be fixed. The Government of India had proposed that the ratio might be allowed to rise to 1*s.* 6*d.* ; but the Committee preferred that Government should issue rupees in exchange for gold (either bullion or coin) at 1*s.* 4*d.*, although this rate was not to be regarded as permanent. It was also recommended that gold should be received at the Government treasuries in satisfaction of public dues at the same rate.

The Committee considered, and rightly so, that the effect of limiting the coinage of rupees would be to raise the rate of exchange, and that the possibility of always obtaining rupees at the rate of 15 for £1 would prevent the rate of exchange rising above 1*s.* 4*d.* This would amount in practice to placing India in the same position as countries possessing the gold standard, at least as far as the foreign trade was concerned ; and it would have the great advantage of securing a stable rate of exchange. The Committee made a thorough survey of the currency systems of all the principal countries of the world as they then existed. They found that many countries had adopted the gold standard to the extent of being able to maintain a stable rate of foreign exchange in gold, whilst there was little or no gold in circulation in the country ; and the actual circulating medium was silver coin and paper money. A striking example was Holland and her colony,

Java, between which and the rest of the world a gold exchange was maintained with practically no gold in circulation and very little in reserve. One country after another had closed its mints to the unlimited coinage of silver, and by this means had been able to keep exchange up to a gold parity. The cases of Russia and Austria were particularly interesting and instructive. In Russia paper money convertible into silver was circulating at a value above that of the silver which it represented ; whilst in Austria the paper money was absolutely inconvertible. Yet owing to the limitation of the amount of paper money issued in each of these countries, its value was maintained, and the exchange was maintained at gold parity. It therefore appeared to the Committee " that it had been found possible to introduce a gold standard without a gold circulation ; without a large stock of gold currency ; and even without legal convertibility of an existing silver currency into gold." It was on these conclusions that they based their recommendations.

Immediately after the issue of the report, the Government of India, by Act VIII of 1893, closed the Indian mints to the free coinage of both gold and silver, Government retaining the power to coin silver rupees on its own account. By notifications issued at the same time, arrangements were made (1) to receive gold at the Indian mints and pay out rupees in exchange for it at the rate of 1*s.* 4*d.* per rupee ; (2) for sovereigns and half-sovereigns to be received in payment of amounts due to Government

at the rate of 15 rupees to the sovereign ; and (3) for the issue of currency notes in exchange for gold coin or bullion at the same rate. It will be observed that gold was not made legal tender in India ; and that, although the Committee contemplated the eventual adoption of the gold standard for India, they did not propose the immediate opening of the mints for the coining of gold. In their view a transition period was necessary in which the rate of exchange would be brought up to 1*s.* 4*d.* When this was achieved, the further measures which might be required for the establishment of the permanent system on a gold basis might be considered.

The effect of these changes was to establish in India a currency system which was in many ways similar to the gold standard systems prevailing in Europe and America, although there was at first no gold actually in circulation. The absence of gold is, however, an important difference between the Indian system then established and the true gold standard. In the latter case, where there is plenty of gold in circulation and in the reserves of the banks, the foreign exchange business is easily regulated by the banks without the intervention of Government, and exchange is kept close to the parity (that is, the mint par between the standard coins of the two countries) because there is plenty of gold available to be exported or imported when there remains a balance of payments due outwards or inwards which it is not possible to settle by other means.

The absence of gold available for export was the

weakness of the system as established in the transition period. Consequently, whilst the arrangement was such as to prevent exchange rising above 1*s.* 4*d.*, there was no means of raising exchange from the level at which it stood when the Committee reported, namely, 1*s.* 2$\frac{5}{8}$*d.* to 1*s.* 4*d.*, or even of preventing it falling further. There was a great volume of rupees in circulation, and more rupees continued to be issued almost to the end of 1893 until the stocks of silver at the mints were exhausted. The price of silver continued to fall, and there was nothing to prevent the rate of exchange also falling, though in actual fact it did not fall to the same extent as the price of silver, so that the limitation of the coining had some effect. The following figures are interesting as illustrating the continued fall of the exchange rate and of the price of silver, whilst they show clearly the way in which exchange was maintained at a higher level by the closing of the mints, and ultimately reached 1*s.* 4*d.* :—

Year.	Intrinsic value of rupee as silver bullion.		Average Exchange value of rupees.	
	s.	*d.*	*s.*	*d.*
1892	1	3$\frac{1}{4}$	1	3$\frac{1}{4}$
1893	1	1$\frac{3}{8}$	1	3$\frac{1}{8}$
1894	0	11$\frac{1}{8}$	1	1$\frac{1}{2}$
1895	0	11$\frac{3}{8}$	1	1$\frac{3}{8}$
1896	0	11$\frac{7}{8}$	1	2$\frac{1}{2}$
1897	0	10$\frac{1}{2}$	1	3$\frac{1}{4}$
1898	0	10$\frac{3}{4}$	1	3$\frac{7}{8}$
1899	0	10$\frac{7}{8}$	1	4

During the years 1894, 1895 and 1896 no rupees whatever were coined, and in 1897-98 the only coinage was on behalf of certain native states.

It is difficult to suppose that, if Indian trade had been in a healthy condition and the country as a whole undergoing its normal expansion, the stock of rupees existing in 1893 would have proved sufficient in volume to prevent the rupee rising to a higher purchasing power in the course of three or four years. It is probable that just at this period, 1896 to 1898, the strongest influence on the level of exchange was the succession of very bad seasons which India experienced. The country at this time was devastated by famine and plague for a succession of years. This considerably reduced the productive power of the country and its exportable surplus of foodstuffs and raw materials. At the same time most European countries were experiencing a severe depression of trade and the demand for Indian goods was slack. At this time therefore India could not experience the usual highly favourable balance of trade, and this doubtless kept the exchange value of the rupee from rising. There was a recovery of trade in 1898, however, and this year saw the exchange rise for the first time to 1*s.* 4*d.* since 1892. It is a curious fact that, after waiting five years, the expectation of the Herschell Committee, that the rate of exchange would rise to 1*s.* 4*d.* as a result of the closing of the mints, was at last fulfilled, just at the time when Government had appointed another Committee, presided over

by Sir Henry Fowler, to consider the future of Indian currency.

Early in 1898 the Government of India addressed the Secretary of State with proposals for securing the early realization of a gold standard in India, which involved a very large withdrawal of rupees from circulation, as they supposed that rupees were still in excess of the requirements of trade. Together with their own proposals Government forwarded two other schemes, one of which—that devised by Mr. A. M. Lindsay, Treasurer of the Bank of Bengal—has become famous. He proposed that a "gold standard reserve" should be created in London, by means of a loan of £10,000,000 raised by the Secretary of State, and to be deposited with the Bank of England. Sterling drafts were to be sold in India when required at 1*s.* 3$\frac{3}{4}$*d.*, and met out of this fund. Conversely, there would be a rupee section of the gold standard reserve kept in India, on which Council bills would be sold in London at 1*s.* 4 1-16*d.* for trade demands when necessary. Mr. Lindsay's scheme was a device whereby Government would use its powers and credit to maintain India's currency system on a gold basis without having gold in circulation. In principle it was an anticipation of the system which was subsequently developed, although the administrative machinery he proposed was considered, and has proved to have been, unnecessary.

The Fowler Committee considered the proposals of the Government of India and the various other

schemes submitted. It is important to note that, with the improvement of trade, exchange rose to 1*s.* 4*d.* by the time the Committee began its sittings. The undertaking of Government, made in accordance with the recommendations of the Herschell Committee, to give rupees in exchange for gold at the rate of Rs. 15 to £1, remained unutilized for some years ; but in 1898, and till 31st March 1899, when the Committee reported, £2,370,000 in gold was paid into the treasuries for this purpose. This event seemed to indicate that the period of uncertainty and distrust had already passed ; and it therefore seemed to the Committee unnecessary to adopt the drastic measures or the elaborate machinery of the schemes submitted to them. They felt that it would be sufficient to limit themselves to the simplest measures which seemed essential to secure the establishment and maintenance of an effective gold standard for India.

The Committee held that it was essential for the welfare of India and Indian trade that the gold standard should be placed upon a firm basis. They pointed out that for a country like India an established gold standard is the simplest and most effective means of attracting capital from abroad. The need of India for foreign capital to secure her economic development was indisputable ; and the need was partly for temporary and partly for permanent investment. There is a seasonal demand for capital for financing the movement of crops and produce for export. This had caused frequent

stringency in the Indian money market, and it was desirable that capital should flow in from abroad for such purposes of temporary finance. London financiers would not risk sending out their money to India if, when they wanted it back a few months later, there was a risk of a movement of exchange having wiped out all the profits and perhaps left them with a loss. The transfer of capital would be encouraged by a fixed exchange, which could only be secured and guaranteed by an effective gold standard. Likewise the flow of capital into India for permanent investment in the shares of companies, etc., would be stimulated, for the investor would not have the uncertainty of the return upon his capital being affected by the fluctuations of exchange.

Briefly, the recommendations made by the Committee were :—

(1) That the British sovereign should be made legal tender in British India, and an endeavour should be made to introduce it as a current coin. The Herschell Committee's recommendation that the sovereign should be rated at Rs. 15, and rupees be made available in exchange for sovereigns at this rate was confirmed. This provision would have the effect of preventing exchange rising above 1*s.* 4*d.* by more than the cost of bringing sovereigns to India where they would be convertible into rupees. In order to facilitate the introduction of gold into actual circulation, the Indian mints were to be opened to the unrestricted coinage of sovereigns and half-sovereigns at as early a date as possible.

(2) As regards the position of the rupee, it was decided not to set any limit on the amount of rupees which should be legal tender. Referring to the legal position of the English silver coinage, the amount of which is limited as legal tender to 40*s.* in one payment, the Committee said, "While it cannot be denied that the 40*s.* limitation tends to emphasise and maintain the subsidiary character of our silver coinage, yet the essential factor in maintaining those tokens at their representative nominal value is not the statutory limit on the amount for which they are legal tender in any one payment, but the limitation of their total issue. Provided the latter restriction is adequate, there is no essential reason why there need be any limit on the amount for which tokens are legal tender by law." This is entirely true, and the Committee reinforced their views by quoting the examples of France and the United States, where the mints had been closed to the unrestricted coinage of silver, but the silver coins remained unlimited legal tender. Furthermore, as the Committee pointed out: "In neither country are such coins convertible by law into gold; in both countries alike they are equivalent to gold for all internal purposes. For international payments, so far as specie is concerned, France and the United States depend ultimately on the international medium of exchange, which is gold. In the last resort, it is their gold which, acting through the foreign exchanges, maintains the whole mass of their currency at its nominal value for internal purposes."

The Committee recommended that the Government of India should not be bound to pay out sovereigns in exchange for rupees presented ; although it would be an advantage that they should pay out gold whenever the stocks of gold in the reserves should so permit, and the people be willing to accept gold.

(3) On the other hand, however, Government should always be prepared to make gold available for export ; because this was the only way of maintaining the rate of exchange at 1*s.* 4*d.* if the balance of payments should be against India. In order to ensure, so far as possible, that gold would be available for shipment, it was desirable to establish a gold reserve. It was recommended that when the coinage of fresh rupees became necessary, the profits of such coinage should not be credited to the revenue, or held as a portion of the ordinary balances of the Government of India, " but should be kept in gold as a special reserve, entirely apart from the paper currency reserve and the ordinary treasury balances. " This reserve, when afterwards established, came to be known as the Gold Standard Reserve, It will be seen that the Committee recommended, not only the establishment of the gold standard in India, but the putting of gold into effective circulation as far as possible. They evidently looked forward to India being eventually placed in possession of a full gold standard currency system. The experience of the next few years led, however, to the idea of putting gold extensively into circulation in India being abandoned as both unnecessary and wasteful.

We shall see how this change of opinion came about.

The continually improving trade and rising prices of the years 1899 and 1900 led to a great demand for rupees in India, so that early in 1900 the stocks of rupees in the Paper Currency Reserve had fallen to Rs. 5 crores. The resumption of coinage became immediately necessary ; but at the same time an attempt was made to force sovereigns into use as an ordinary medium of currency. The results were not encouraging, as most of the sovereigns very soon found their way back again into the treasuries, and in some places sovereigns went to a discount of as much as four annas. Since 1900 no general attempt to force sovereigns into circulation has been made ; although they were freely used at certain periods of the war in the purchase of supplies for Government in those parts of India where the public would accept them. Government failed, through no fault of its own, to carry out some of the Fowler Committee's recommendations. The British Treasury raised difficulties about the coinage of sovereigns in India ; and after long negotiations, and in the apparent absence of any public demand for gold as currency, the idea was abandoned in 1902.

The year 1900 marks the turning point in currency policy. Thereafter the object was not to allow too much gold to accumulate in the paper currency reserve. From 1904 the Secretary of State kept open a standing offer to sell Council Bills without limit at 1*s.* 4⅛*d.* This was done in order to meet the demand of traders to finance the Indian exports, the object

being to prevent the accumulation of gold to an unnecessary extent in India, with the probability of expense having to be incurred in shipping the gold back to London when the balance of trade might turn against India.

The position of the silver rupee in the currency system was not in practice changed to the extent anticipated by both the Currency Committees. The rupee had in fact become a token coin representing the fifteenth part of the sovereign ; but nevertheless, as a medium of circulation, it was still preferred to gold. This remains true to the present day, and it will probably be many years before sovereigns come into active and regular circulation. The lesson learned, however, from the refusal of the public generally to use sovereigns, was that it is necessary for a large proportion of the metallic part of the Paper Currency Reserve to be held in silver, and not too large a part of it in gold. Otherwise, when in good seasons a strong demand for currency sets in, the reserve might be drained of practically all its silver, and it would be necessary again to attempt to force gold into circulation. The object of Government is to be able to offer people the kind of currency medium which they demand—silver, gold or paper money.

In the few years before 1913 there had been a good deal of public criticism of the methods of sales of Council Bills, the handling of the large balances kept by the Secretary of State in London, and the alleged failure of the Government of India to carry out

some of the principal recommendations of the Committee of 1898. The Royal Commission on Indian Currency and Finance was appointed therefore in that year, and its report was available in the spring of 1914. The Commission reviewed Government's management of the currency since 1898 and expressed a favourable opinion on it. "The time has now arrived," they said, "for a reconsideration of the ultimate goal of the Indian currency system. The belief of the Committee of 1898 was that a Gold Currency in active circulation is an essential condition of the maintenance of the Gold Standard in India, but the history of the last 15 years shows that the Gold Standard has been firmly secured without this condition." They added that, "the people of India neither desire nor need any considerable amount of gold for circulation as currency, and the currency most generally suitable for the needs of India consists of rupees and notes." Having come to the conclusion that gold in actual circulation was not needed for maintaining the currency system on a gold basis, it was natural that they concluded, in opposition to the Committee of 1898, that a mint for the coinage of gold in India was not required. They conceded, however, that, if Indian sentiment generally demanded that gold should be coined in India, there was no objection to it in principle, provided that the coin minted would be the sovereign or half-sovereign. Other recommendations of the Royal Commission of 1913-14 will be found in the next chapter.

Since the recovery of trade in 1898, there were only two periods of weakness of exchange up to the date of the outbreak of the Great War. The first was in 1900-1. The sale of Councils was reduced, and a lower average rate was obtained than in previous years. The second period of exchange weakness was in 1907-8, and this was far more serious. This time the balance of trade turned strongly against India, and the demand for Councils ceased. Government only allowed comparatively small issues of gold for export, and exchange fell to 1*s.* 3 13-16*d.* A few days later the lowest point reached was 1*s.* 3 11-16*d.*, just before the notice was issued that Reverse Sterling Telegraphic Transfers would be sold at 1*s.* 3 27-32*d.* Altogether during the few months for which Reverse Councils were sold nearly £9-millions were withdrawn from the Gold Standard Reserve in London ; and the Secretary of State, for his own expenditure, had to draw upon the gold in the London branch of the Paper Currency Reserve, rupees to a corresponding amount being added to the Reserve in India. It will be observed that each of these periods of exchange weakness occurred at a time when the general level of prices throughout the world had reached a maximum in a boom of excited trade. There was a boom of trade in many parts of the world in 1900 succeeded by a collapse of prices. The boom of trade in 1906-7, however, was much greater, and the collapse of prices which began in the summer of 1907 was so severe that it created a financial panic of unusual severity in America. It is natural that

the balance of trade should turn against India when world prices suddenly fall (see pages 178, 257, 288, and pages 300 to 308).

In concluding this chapter, it will be of interest to summarise briefly the results obtained by the series of measures which followed the momentous step taken in 1893 of closing the mints to the free coinage of silver, and undertaking to convert gold into rupees at the rate of Rs. 15 for the sovereign. The rise of exchange to 1*s.* 4*d.* was achieved by 1898 ; but the full establishment of the Gold Exchange Standard may be said to date from 1901, when the accumulation of a substantial sum in the Gold Standard Reserve gave some measure of security that exchange would not fall below 1*s.* 4*d.* By this time also gold had become a very important part of the Paper Currency Reserve, there being 867 lakhs of gold coin and bullion as against 11,20 lakhs of silver. The system of the Gold Exchange Standard, as it evolved in practice, was that the rupee remained the effective coin in circulation, replaced more or less by currency notes ; and that for foreign exchange purposes gold was convertible into rupees, or rupees into gold, at the fixed rate of 1*s.* 4*d.* Although sovereigns circulated to a very small extent in India, the silver rupee had become a token coin representing the fifteenth part of a sovereign.

One practical effect of the conversion of the rupee into a token coin was that the price of bar silver in India was no longer fixed at the par of Rs. 106-6-0,

but fluctuated in accordance with the price of silver in the world's markets. By 1898, for example, the price of bar silver had fallen as low as Rs. 70 per 100 tolas. It was, therefore, no longer profitable to melt up rupees, if silver were required for making jewellery, or any other purpose. At the same time Government was in a position to make a considerable profit upon the coinage of rupees, because it could purchase bar silver in England at a rate corresponding to Rs. 70, or less, per 100 tolas of pure silver, and convert it at a cost of about Rs. 3 into rupees which were worth Rs. 109 per 100 tolas. Putting it another way, the rupee, which was now maintained at the value of 1*s.* 4*d.* (that is, 16*d.*) for foreign exchange purposes, contained silver which actually cost only 10*d.* This large profit on the coinage went to building up the Gold Standard Reserve.

Very great benefit has accrued to India by the fixation of the price of the rupee ; for, if exchange had continued to follow the price of silver downwards, the rupee would have fallen to 10*d.*, which would have involved a considerable increase of taxation in order that Government might meet its liabilities. Moreover, the mere fact that exchange had been fixed and no longer fluctuated from week to week with the price of silver was a very great benefit to Indian foreign trade. A fluctuating exchange makes the business of a merchant, whether exporter or importer, far more risky, for his whole profit may be wiped out by an alteration of the exchange rate.

Another great advantage of the closing of the mints was that the rise of prices in India was checked, or at least retarded. Had India retained the silver standard after 1893, silver must have continued to flow into the country in greater and greater quantities, as the world's price of silver fell. Prices in India, which had previously been stationary, or had risen slightly when world's prices were falling, must have risen all the faster in the succeeding period from 1895, when world prices, that is, in the gold standard countries, started rising rapidly. The holders of the then existing stock of rupees benefited by the fact that the purchasing power of the rupee was raised from its mere bullion value to its new legal position of representing gold to a value nearly 75 per cent greater.

The total volume of Indian foreign trade, that is to say, exports and imports of merchandise combined, grew from 185 crores in the financial year 1898-99, when exchange first reached 1*s.* 4*d.*, to 440 crores in 1913-14, the last complete financial year before the outbreak of the Great War. The result of the fixation of the exchange was to bring India far more closely in touch than she ever before had been with the international markets of the world.

CHAPTER XII

RESERVES AND BALANCES

The various reserves and balances held by the Government of India and by the Secretary of State are of such importance in the maintenance of the Indian system of currency and finance, as it has developed during the present century, that it seems desirable to describe them somewhat more in detail than was possible in the preceding chapters. The stability of the Indian currency system, and the financial credit of India in the monetary centres of the world, depends very largely upon the handling of these reserves and balances ; consequently it is important that the public should realise their exact nature and the purposes which they have to fulfil. It will be convenient to consider the balances and the reserves historically in the order in which they came into existence.

The business of managing the finance of so great a country as India is one of extreme complexity, requiring the most careful adjustments of revenue and expenditure. It is obvious that Government can never afford to be without considerable sums of ready money, which may be available for expenditure at any moment in whatever part of the country money may be required. The Government's cash is held mainly in Government Treasuries in all parts of India, also as deposits in the Imperial

Bank ; whilst a certain amount of ready money is also required by the Secretary of State in London. All these balances and reserves of ready money are spoken of collectively as the Treasury Balances.

Looking back a hundred years in the history of India, we find that, apart from a few banks in Calcutta, there was no banking organisation whatsoever in the country. Government could not therefore utilise any private agency for handling its funds ; but was obliged to make some arrangement for keeping money safely, and for remitting sums from place to place. The collection of the revenue being entrusted to a Collector or Deputy Commissioner in charge of each district, it was naturally most convenient to establish a treasury at the headquarters of each district. These are known as the District Treasuries, and into them is regularly paid the land revenue and other taxes collected within the district, and out of them are paid the salaries of all Government officers, and many other necessary disbursements for all the expenses which Government has to meet. Each district is divided into two, three or more Tahsils or Taluks, and in each of these is a Sub-Treasury. In the first instance the revenue is paid into these, and it is thence mostly transmitted to the district treasury, as the sub-treasuries are allowed only to keep comparatively small balances, and payments are mostly made direct from the district treasuries. Wherever there are branches of the Imperial Bank, these, as well as the local head offices, are utilised to keep

Government balances and to do a great deal of Government business. There is usually, however, a District Treasury in the same town ; but its staff is much smaller than would be necessary if the business were not so largely transacted through the branch of the Imperial Bank.

Apart from the general system of district treasuries which carry on the daily business, there used to be three Reserve Treasuries, which were established about forty years ago in each of the Presidency towns. The function of these was to keep large sums of money available for expenditure in case of any serious emergency, such as widespread famine or war. Experience proved that it was not possible for Government to deposit very large sums with the Presidency banks in the expectation of being able to withdraw them at short notice. When, in 1874, Government wished to withdraw Rs. 30 lakhs from the Bank of Bombay to finance famine relief in Behar and Northern Bengal, the Bank was unable to pay ; and had Government insisted, the bank would have failed, and there would have been a widespread financial panic. It is indeed not good banking business to accept very large sums on deposit withdrawable at comparatively short notice ; because a bank is unable to make its investments in such a way that it could realise a large sum in a short time. Bills discounted take time to mature ; and even if it has a large reserve invested in Government securities, the result of forcing the sale of a large quantity of these at one time is to depress the price and so involve the bank

in heavy loss. As it is necessary for Government to have large reserves in India, and will continue to be necessary until private aggregations of capital are greatly increased and the banking organization much more highly developed, the only practicable course, until the establishment of the Imperial Bank, was for Government to have its own Reserve Treasuries.

The following table illustrates the disposition of the treasury balances. It shows the amount of funds kept in each kind of treasury, in the Presidency banks, and the amount with the Secretary of State in London. The statement of the amount of the treasury balances is published monthly by Government; but I have chosen for illustration the balances at the close of the financial year a little while before the war and at the latest date available :—

	31st March 1913.		31st March 1921.	
	No. of Treasuries or offices of banks.	Balance.	No. of Treasuries or offices of banks.	Balance.
		Rs. lakhs.		
Reserve Treasuries ...	3	12,68	0	...
District Treasuries ...	272	13,87	264	7,47
Presidency Banks :—				
(Imperial Bank)—				
Head Offices ...	3	2,38	3	6,41
Branches ...	42	3,27	68	
Secretary of State in London.	1	£8,783,970	1	£7,265,265
Equivalent at 2*s.* ...	...	Rs. lakhs 8,78		Rs. lakhs 7,26

It may be pointed out that the balances with the Secretary of State are large at the close of the financial year, because it is necessary to accumulate funds in advance to pay the interest charges on the public debt of India which are due in London early in April.

The balances of Government lodged with the Presidency banks may appear high at first sight. As part of the arrangement with the Presidency banks, by which they handled Government business, much of it involving a great deal of detailed and unremunerative work, the Government undertook not to draw upon its cash balances below the following figures :—

At the Bank of Bengal, Rs. 100 lakhs.
At the Bank of Bombay, Rs. 50 lakhs.
At the Bank of Madras, Rs. 30 lakhs.

As a rule, however, the actual balances deposited with the banks were as a matter of convenience considerably larger. This was not of any particular advantage to the banks, however, in so far as large sums were liable to be withdrawn on demand or at short notice. The agreement with the Imperial Bank of India is slightly different. There is no minimum balance, but all the balances of Government except those in treasuries where there is no branch of the Imperial Bank are deposited with it.

It may be added that the Treasury Balances of the Government of India are a consolidated fund very much like the cash balances of a bank ; for the Balances include sums belonging to all manner of

different accounts. There are many local funds in the different provinces, whose accounts and balances are kept with Government ; most of the District Boards and municipalities " bank " with Government, and the Balances include also the deposits in the Post Office Savings Bank, and certain provident funds. Money is always pouring into the Treasuries, and at the same time flowing out day by day in a continuous stream. The Balances represent the actual cash in the hands of Government at any one moment. Any physical separation of these Balances according to the separate heads is quite unnecessary. The amount at credit of any particular account being exactly known at any moment in the Office of the Accountant General, it can always be paid out when necessary. All that is essential is that the Treasury Balances as a whole should be large enough to meet any probable call upon them for the payment of actual cash. The principle is exactly the same as that which applies to the cash reserves held by banks.

Paper Currency Reserve

The Paper Currency Reserve was established, as explained in a previous chapter, to secure the convertibility of the currency notes which were first issued by Government in 1862. This Reserve is entirely separate from the Treasury Balances. Not only are separate accounts kept, but the actual cash or money in the Reserve is kept separate. Treasury Balances consist partly of silver coin, occasionally a little gold coin, and a large amount of currency

notes. The Paper Currency Reserve obviously cannot contain any currency notes. It was established in order to maintain the convertibility of the notes, and must therefore consist largely of actual silver and gold coin. The object of Government is to hold so much silver coin in the Reserve as is likely to be needed for any possible demand for encashment of currency notes in rupees for use within India ; and to hold gold to such an amount as to be more than sufficient to meet any likely demands for the encashment of notes for purposes of exporting the gold from India to other countries, a demand which would naturally occur when the balance of payments is against India. Government does not undertake to convert its notes into gold for the general public, who would presumably use the gold for purposes of internal circulation, or to melt it up ; but when the amount of sovereigns in the Reserve is large in proportion to the amount of rupees, the public can usually, as a matter of favour, obtain payment of their currency notes in gold.

In addition to silver and gold coin the Paper Currency Reserve includes silver bullion and gold bullion, usually in the form of bars weighing about 100 tolas each. The silver bullion so held in Reserve is usually coined into rupees as soon as the mint is in a position to do the work. The gold bullion in the Reserve, on the other hand, is very often kept permanently in this form, because it will be issued only for export, and is quite as useful for that purpose in the form of bars, as it would be in coin. Sometimes, however, the gold bullion in the Reserve is coined for internal use, as was done in 1918, when the

"gold mohurs," or fifteen-rupee pieces, of the same weight and fineness as the sovereign, were issued. The total amount of gold and silver coin and gold and silver bullion contained in the Reserve is called the *metallic* portion, as distinguished from the invested portion, of the Reserve.

As explained in Chapter IV, it is not necessary that the whole of the currency notes issued should be backed by gold or silver in order to ensure convertibility. In ordinary circumstances, it is highly unlikely that notes to the extent of more than one-fifth, or at most one-fourth, of the total issue would be presented for encashment within a short time. Even in a political emergency like war, or a financial crisis, it seems highly improbable that more than one-third of the total outstanding notes would be presented for encashment within a short time ; and it has always been considered safe therefore to allow a considerable proportion of the whole Reserve to be constituted of investment securities, either the rupee debt of the Government of India, or loans of the British Government.

We may now see how the Paper Currency Reserve has been changed from time to time at different periods in its history. Soon after it was instituted, namely, in December, 1863, the composition of the Reserve was as follows :—

	Rs.
Silver Coin	1,93,22,868
Silver Bullion	1,17,00,000
Government Securities . .	2,00,77,132
Total circulation Rs. . .	5,11,00,000

The securities were at first those of the Government of India only. The Paper Currency Reserve is regulated entirely by Acts of the Legislative Council of India ; and a succession of Acts has permitted the increase of the invested portion of the Reserve from time to time : to Rs. 6 crores in 1871, to Rs. 8 crores in 1890, and to Rs. 10 crores in 1896. In 1905 the principle was introduced for the first time of allowing the invested portion of the Reserve to be held partly in securities of the United Kingdom. The limit then placed was Rs. 2 crores, which was raised to Rs. 4 crores by an Act of 1911. This remained the limit until 1915, when the exigencies of the war led to successive further increases of the invested portion, as mentioned later in this chapter.

The Act of 1861 permitted the Government of India to issue notes against gold coin or bullion ; but the power was not exercised until 1865 when there were Rs. 20 lakhs of gold in the Reserve. The quantity gradually diminished, however, and gold entirely disappeared from the Reserve after 1875.

The principle of issuing notes against gold held, not in India, but by the Secretary of State in London, was introduced for the first time by an Act of 1898. It was intended as a temporary measure, the Treasury Balances in India being low and the demand for Council Bills active. Gold therefore was purchased in London, and notes were issued against it in India, wherewith to pay the Council Bills. It was son recognised, however, that this practice

could be of more than temporary utility, and an Act of 1900 extended the period of these powers, and gave Government other extensive powers, especially the issue of currency notes against silver bullion purchased by the Secretary of State and in transit to India. Thus gold or silver in transit to India, from its location as part of the Paper Currency Reserve in England, is a part of the Reserve whilst in transit (Acts of 1902, 1905 and 1910). In the ordinary course notes have been very commonly issued against silver bullion purchased in England, or in America, and in transit to India, the value of the silver bullion being estimated by converting its cost in pounds sterling into rupees at Rs. 15 to £1. On reaching India it is replaced in the Reserve by freshly coined rupees from the mint; and it is on this issue of coins from the mint that the profit on coinage is realised. In times of active trade, when there is a strong favourable balance of payments, gold tends to flow into India ; and some of it is presented for exchange into rupees, so that the gold portion of the Reserve continually increases. The following table shows the position of the Currency Reserve at successive dates so as to illustrate the principal changes. The percentage which the metallic portion of the Reserve bears to the whole is indicated in the last column. It will be seen that it is a very variable figure.

PAPER CURRENCY RESERVE.

Year (last day in March)	Total Note circulation. Rs. lakhs.	COMPOSITION AND LOCATION OF THE RESERVE. (in Rs. lakhs.)						
		SECURITIES.		METALLIC RESERVE.				
		In India.	In England.	Silver.	Gold in England.	Gold in India.	Total Metallic Reserve.	Percentage of the Metallic Reserve to Total Note circulation.
1865 ...	7,43	3,57	...	3,65	...	20	3,85	51·9
1870 ...	10,47	3,60	...	6,84	...	3	6,87	65·6
1875 ...	11,24	5,69	...	5,54	...	1	5,55	49·3
1880 ...	12,36	6,00	...	6,36	...	...	6,36	51·5
1885 ...	14,58	6,00	...	8,58	...	...	8,58	58·8
1890 ...	15,77	6,00	...	9,77	...	...	9,77	62·0
1895 ...	30,70	8,00	...	22,70	...	...	22,70	73·9
1900 ...	28,74	10,00	...	5,24	2,25	11,25	18,74	65·2
1905 ...	39,18	10,00	...	13,07	...	16,11	29,18	74·5
1906 ...	44,66	10,00	2,00	16,34	10,57	5,73	32,64	73·1
1907 ...	46,95	10,00	2,00	18,91	10,54	5,49	34,94	74·4
1908 ...	46,88	10,00	2,00	25,26	5,56	4,06	34,88	74·4
1909 ...	45,48	10,00	2,00	31,20	2,25	3	33,48	73·6
1910 ...	54,41	10,00	2,00	29,36	3,75	9,30	42,41	78·0
1911 ...	54,99	10,00	2,00	26,14	7,57	9,27	42,98	78·2
1912 ...	61,36	10,00	4,00	15,48	8,55	23,33	47,36	77·4
1913 ...	68,98	10,00	4,00	16,45	9,15	29,37	54,97	79·7
1914 ...	66,12	10,00	4,00	20,53	9,15	22,44	52,12	77·8
1915 ...	61,63	10,00	4,00	32,34	7,65	7,64	47,63	77·3
1916 ...	67,73	10,00	10,00	23,57	11,92	12,24	47,73	70·4
1917 ...	86,37	10,00	34,49	19,21	6,67	12,00	37,88	43·9
1918 ...	99,79	10,00	51,48	10,79	67	26,85	38,31	38·4
1919 ...	1,53,46	16,08	82,50	37,39	12 (in transit)	17,37	54,88	35·8
1920 ...	1,74,52	19,58	6,72	39,85	3,45	44,37	87.67	50·3
1921 ...	1,66,16	68,07	8,35	65,57	...	21,47	87,04	52·4

The actual location of the metallic portion of the Paper Currency Reserve is worthy of attention. The whole of India is divided up for purposes of paper currency into seven "circles," each of which has its own Currency Office for issue and encashment of notes, and for storing a part of the Reserve. The Currency Offices are located in the principal commercial towns, and the circles are arranged so that these towns form convenient centres. Each circle is known by the name of the town in which its Currency Office is situated. The seven circles are Calcutta, Cawnpore, Lahore, Bombay, Karachi, Madras and Rangoon.

The metallic part of the Reserve is not confined, however, to the Currency Office, but a portion of it is distributed throughout each circle, being deposited in what are called "Currency Chests" kept in the District Treasuries and in many branches of the Imperial Bank. The coin kept in these currency chests is of course quite separate from the Treasury Balances. The keeping of a portion of the Reserve in this way in every district is intended to facilitate the encashment of the notes in coin, or giving out notes in exchange for coin paid in. Small exchanges with the public are made at first from the treasury funds, exchanges of large amounts of notes into coin, or *vice versa,* being made from the currency chest whenever necessary. This distribution of part of the Paper Currency Reserve in the District Treasuries is a means of ensuring immediate convertibility of the notes, and avoiding unnecessary

transfers of coin.

The exact composition of the Paper Currency Reserve, and its disposition in the different currency circles, can be learned each week from the detailed statement which is published in the *Gazette of India,* and which is reproduced in more or less condensed form by most of the newspapers. A recent statement is printed in Appendix IV (page 316) by way of illustration in a slightly abbreviated form. Under "Coin and bullion" five columns relating to silver and gold in transit to India and in England are omitted, as there was no entry, and in all the columns the figures are here printed to the nearest complete lakh of rupees. On studying the table it will be observed that the total amount of notes in circulation is shown in the left hand column. The total issue from each Currency Office is shown, and in column 1 appears the amounts of each issue retained in the Reserve Treasuries. Deducting this from the total issue, we have a figure which represents what is called the "net circulation." This is the total shown at the foot of the column headed "Elsewhere." Most of the columns under the heading "Reserve" explain themselves. In column 16 appears the total amount of the Reserve located at or credited to each Currency Office, whilst the total at the foot of column 16 is the total amount of the Reserve. It will be seen that this is smaller than the total of the notes issued; and the difference is made up by the notes which have been withdrawn from circulation by foreign circles, that is, others

than circles of issue, and are in course of remittance to the circle of issue for cancellation. After deducting this sum from the total issue, the Reserve is found to be exactly equal to the total of notes in circulation.*

The Gold Standard Reserve

It was stated in the last chapter that the Fowler Committee recommended that the profits from the coinage of rupees should be set aside as a gold reserve to assist in maintaining exchange. This principle was adopted by Government ; and as soon as coinage was recommenced in 1900, the entire profit was credited to this reserve. On 31st March, 1901, it amounted to £3,031,000, all held in India, of which £1,200,000 was in gold. A year later the Gold Reserve had increased to £3,304,000 ; but by the sale of Council Bills, the whole of this sum had been transferred to London, and was there invested in sterling securities. The Reserve was held in this form, entirely in London, until 1906, when the rupee branch of the Gold Reserve was established in India, and the name was changed to the Gold Standard Reserve. Of the total Reserve, which amounted at 31st March, 1907, to £16,842,000, £4,000,000 (then Rs. 6 crores) was held in rupees in India.

The holding of silver rupees in the Gold Standard Reserve did not commend itself to the Royal Com-

* Since the above was written the Reserve Treasuries have been abolished, the notes therein having been deposited with the Imperial Bank early in 1921. Columns 1 and 2 have therefore disappeared from recent statements.

mission of 1913-14 as a satisfactory policy ; and they recommended that the Gold Standard Reserve should always consist either of actual gold in England or India, or of sterling securities which would be convertible into gold by sale in London. It seemed illogical that there should be a quantity of rupees in the Gold Standard Reserve in India, and a large quantity of gold in the Paper Currency Reserve. The latter was the appropriate location for the whole reserve of silver. They therefore recommended an exchange of the rupees in the Gold Standard Reserve for an equivalent amount of gold taken from the Paper Currency Reserve ; and this was done early in 1915, thereby closing the rupee branch of the Gold Standard Reserve.

In 1907 the Secretary of State was of opinion that the Gold Standard Reserve was already nearly large enough to meet any probable demand for Reverse Councils, and that in future only half the profits of the coinage need be credited to the Reserve. A small Committee at the India Office recommended that half of the profits of the coinage might be appropriated to capital expenditure upon railways. A sum of £1,123,000 had been thus diverted when the balance of trade turned strongly against India and Reverse Councils had to be sold freely ; which led to the conclusion that in future the whole of the profits of the coinage should again be credited to the Reserve, and also the whole of the interest received on the securities forming the invested portion of the Reserve. This policy

has been acted upon right up to the present time.*

The Committee on Indian Currency (1919) had little to say about the Gold Standard Reserve, for they approved generally the location of nearly all of its funds in London. They considered that the securities held in the Reserve should be such as have early dates of maturity. Gold should be held rather in the Paper Currency Reserve than in the Gold Standard Reserve ; but when practicable the latter should consist partly of gold of which a portion, not exceeding one-half, should be in India, to be made available to the public only for purposes of export. In the Committee's view it was not really necessary to have any gold in the Gold Standard Reserve and the proposal to hold gold in India was a concession to Indian sentiment. There is much to be said in favour of their view that the most convenient form in which to hold this reserve is in short-dated securities of the British Government ; for since the date of repayment of these is always near at hand, they are not liable to depreciation, and can always be converted into cash practically at their face value when necessary for meeting Reverse Councils. At the same time it is obvious that whilst Reverse Councils are being sold, and thereafter, the composition of the Gold Standard Reserve must be altered. The sale of Reverse Councils operates to transfer the Reserve from London to India ; and in this country it will then be held in gold (by exchange with the Paper Cur-

*But see below pages 168 and 187.

rency Reserve) and, if necessary, also in rupees and in rupee securities. When the balance of trade turns and becomes favourable to India, Councils will be sold again and these will probably be paid at first from the Treasury Balances until the Secretary of State's requirements for cash have been met, and thereafter next from the rupees, and then from the rupee securities and gold of the Gold Standard Reserve. The economic conditions dictate that this Reserve must be held alternately in sterling in London, or in gold or rupees in India, according to the state of the balance of trade.

The extensive currency changes of 1920 did not affect the Gold Standard Reserve ; but the Government of India announced through the Finance Member a slight change of policy. When the Reserve should have reached the amount of £40,000,000 they considered that it would no longer be necessary to accumulate the interest on the securities. This would be diverted to assist in making good the gap caused in the Paper Currency Reserve by the revaluation of its holding of gold and sterling securities*.

* See later in this Chapter, page 187.

The following table gives figures representing the position of the Gold Standard Reserve on three representative dates :—

COMPOSITION OF THE GOLD STANDARD RESERVE

	30th June 1913.	30th June 1915.	30th June 1920.
In England :—	£	£	£
Securities*	15,941,086	12,082,579	36,743,809
Cash at Bank of England and at short notice.	1,015,290	45,695	1,168
Gold deposited at Bank of England.	1,730,000	1,350,000	...
In India :—			
Loans and Book credits ...	...	7,000,000†	...
Gold	...	5,241,389	...
Silver	4,000,000	...	...
Total ...	£22,686,376	£25,719,663	£36,744,977

* The sterling securities are revalued at market prices twice yearly on 31st March and 30th September; and additional securities purchased between these dates are shown at cost price.

† The profits on recent coinage were temporarily lent to the Treasury Balances in India.

ROYAL COMMISSION ON INDIAN CURRENCY AND FINANCE

The Royal Commission on Indian Currency and Finance which was appointed in 1913-14 made the most exhaustive investigation of the position and location of the Reserves and Balances of the Government of India, and of the management of the

business connected with them, and of exchange operations. The recommendations of the Commission as regards the gold currency have already been mentioned (see Chapter XI, page 147) : it will be sufficient here to review briefly their recommendations as regards the Reserves and Balances. Their most important recommendations were those connected with the Paper Currency Reserve. They observed that the system of regulating the issue of the paper currency had been modelled on that of the Bank of England which allows a fixed fiduciary issue and requires that the whole of the notes issued in excess of this amount must be backed by gold. The Indian currency law also permitted a fixed issue of notes on a fiduciary basis (by which is meant the invested portion of the Reserve) ; but as the total circulation of notes increased, and the invested portion of the Reserve became therefore continually a smaller and smaller percentage of the whole, the fiduciary portion was from time to time increased by successive Acts of the Legislative Council.

These sudden changes of the Reserve, made, not on any fixed principle, but according to the requirements of the time, did not satisfy the canons of good management of a paper currency as understood in modern times. It is true that by successive new Acts of the Legislature, the invested portion of the Reserve can be expanded from time to time in accordance with the demand of the public for increased note circulation, and this practice was adopted during the war. Such spasmodic increases

of the fiduciary portion of the Reserve can only take place at intervals, however. In practice, for good regulation of the paper currency, a natural elasticity is required, which allows the fiduciary portion of the reserve to expand or contract according to the requirements of the public for notes. In the busy season of the year, the money market becomes tight in Bombay and Calcutta, and the rate of discount rise inconveniently high. At such times more money is needed in circulation, and it would be perfectly safe to increase the circulation of notes without depositing the corresponding amount of gold and silver in the Reserve for every additional note issued. The necessity of adding to the metallic portion of the Reserve a sum exactly equal to the increased circulation of notes deprives the paper currency of elasticity, for there is a demand for rupees when the money market is tight.

It would be possible for Government to give some elasticity to the paper currency circulation by the device of obtaining sanction by an Act of the Legislature to a large portion of the Reserve being of a fiduciary character, but adopting the practice of not making use of its power of issuing notes against securities up to the limit. Thus at a time when the money market became stringent, they could issue notes against further investments, and subsequently contract the total circulation and the invested portion of the Reserve simultaneously. Such a method of regulating the currency would require constant and careful watching ; and the legislative

enactments of other countries have sought various legal devices for giving elasticity to the paper currency circulation whilst yet prescribing a definite rule of management. With this object in view the Royal Commission on Indian Finance (1913-14) recommended that the fiduciary portion of the note issue should be increased at once from 14 to 20 crores, and that thereafter it should be fixed at a maximum equal to the amount of the notes held by Government in the Reserve Treasuries *plus* one-third of the net circulation. They further recommended that Government should take power to make temporary investments or loans from the fiduciary portion of the Reserve within this maximum both in India and in London, as an alternative to investments in permanent securities. It will be seen that this would allow a certain degree of elasticity, and would allow Government to assist the money market by making loans from the Paper Currency Reserve, preferably through the Imperial Bank. It would still be necessary, however, that for every Rs. 30 increase of the circulation two-thirds of this amount, *i.e.*, Rs. 20, should be added to the Reserve in the form of gold or silver. The recommendation of the Currency Committee of 1919, which is dealt with in a subsequent chapter, was more liberal as they proposed that the fiduciary portion of the Reserve should form 60 per cent of the whole circulation.

The Paper Currency Reserve in War Time

As will be explained in a later chapter*, the grow-

* See Chapter XIII, pages 193 and 195.

ing demand for Council Bills, the necessity of financing the employment of the Indian Army abroad, and the export of munitions and goods of national necessity for the prosecution of the war led not only to the importation of enormous quantities of silver but to the need for the expansion of the note-issue against securities. The absorption of silver was so rapid with the rising prices in India, that no considerable amount could be retained in the Paper Currency Reserve. Enormous quantities of rupees were being coined ; but they seemed simply to pass through the Reserve and disappear amongst the rural population. Local merchants had to cash their currency notes in silver in order to pay the cultivators ; and these latter and the *banias* hoarded silver.

For these reasons successive Ordinances, and subsequent Acts of the Legislative Council, were necessary in order to increase the powers of the Controller of Currency to issue notes against securities. The following table shows how the total amount of securities allowed to be held in the Reserve was increased from time to time, and it also shows in the third, fourth and fifth columns the limits assigned to the various classes of securities within the prescribed total. It will be understood that the figures in the third to fifth columns are in a sense alternatives. The securities of these classes could not all be held up to the maximum limit of each class at the same time, as the general limit of all securities came into operation preventing that.

Limits of Invested portion of the Paper Currency Reserve

(IN CRORES OF RUPEES)

Column No. 1.	2	3	4	5	6
Authority.	Total permissible of all securities.	Rupee securities.	Sterling securities.	British Treasury Bills.	Commercial Bills.
Act XIX, 1861 ...	4	4	...	...	...
„ III, 1871 ...	6	6	...	...	...
„ XV, 1890 ...	8	8	...	...	...
„ XXI, 1896 ...	10	10	...	...	...
„ III, 1905 ...	12	12	2	...	...
„ II, 1910 ...	12	12	2	...	...
„ VII, 1911 ...	14	14	4	...	...
„ V, 1915 ...	20	20	4	...	...
Ordinance I, 1916 ...	20	20	10	...	...
Act IX, 1916 ...	26	20	10	6	...
Ordinance VI, 1916	38	20	10	18	...
„ VII, 1916	50	20	10	30	...
„ VII, 1917	62	20	10	42	...
Act VI, 1918 ...	86	20	10	66	...
„ II, 1919 ...	100	20	10	80	...
„ XXVI, 1919 ...	120	20	10	100	...
„ XXI, 1920 ...	120	120	120	120	...
„ XLV, 1920, Temporary.	85	85	85	85	5
Ditto, Permanent.	=Metallic Reserve.	20	...	=Metallic Reserve.	5

The securities of the Government of India, and the sterling securities originally held in the Reserve (Column 4) are permanent loan stock or long dated securities. The rapid depreciation of such securities with the growth of the British national debt during the War, led to a change of policy. Power was therefore taken in Act IX of 1916 to hold six crores of British Treasury Bills which mature for repayment after not more than twelve months and

are therefore not liable to depreciation. The Act of 1920 passed in April of that year was important because, although it did not increase the total amount of securities admissible in the Reserve, it abolished the limit on the holding of securities of the Government of India. As noted in a later chapter, this was done on account of the adverse balance of trade and the necessity for selling Reverse Councils which began in January, 1920, these for the greater part being met out of the sterling securities of the Paper Currency Reserve. So far as the circulation was not contracted, this operated to transfer part of the invested portion of the Reserve to India, where it was naturally desirable to hold it in securities of the Government of India.

Report of the Currency Committee, 1919

The Report of the Committee on Indian Exchange and Currency (1919) is described in a later chapter*; but it will be more convenient to notice here its recommendations as regards the composition of the Paper Currency Reserve. The Committee had to consider in regard to this the peculiar position which had been reached by the absolutely necessary expansion of the circulation during the war and subsequently. This had been achieved mainly by enlarging the invested portion of the Reserve, the increased investment being in sterling securities held in London. The last change was made by Act XXVI of 1919 which fixed the invested portion of the Reserve at 120 crores, of which 100

* See Chapter XIV, page 220.

crores might be invested in Treasury Bills of the British Government. This meant that considerably more than half of the total circulation at the time the Committee reported (186 crores) could be held in British securities. If, as was probable, there should be a contraction of the gross circulation in future years, the limit would become unduly high and would have to be reduced from time to time by special legislation.

The Chamberlain Commission had pointed out the disadvantage of the inelasticity of the Indian Paper Currency system.* During the past six years a substitute for elasticity had been found in the issue of frequent Ordinances and the passing of Acts. The Committee found that it was essential to introduce elasticity into the system and thus " to obviate the necessity for constant fresh applications to the legislature as the circulation grows. Both these objects can be attained," they said, " if instead of laying down that the invested portion of the Reserve must not exceed a fixed maximum, the legislature prescribes that it shall not exceed a maximum percentage of the total issue ; or alternatively, that the metallic portion shall not fall below a minimum percentage of the total issue."

The Committee also made a further most important recommendation, namely, to try experimentally on a small scale the device proposed by the Royal Commission of 1913-14 for giving the note-issue

*Report, 1914, paragraphs 103-105.

elasticity—one which has been adopted in connection with the Federal Reserve Note System in the United States : that is to make commercial bills of exchange available as security for the issue of notes.

The Committee recommended that this should be done to the extent of five crores in addition to the other forms of security already permissible. "The issue would take the form of loans granted to the Presidency Banks on the collateral security of bills endorsed by the Presidency Banks and having a maturity not exceeding 90 days." They proposed that the Banks should be charged at not less than 8 per cent per annum for such advances. Thus there would be no temptation for the Banks to make this an ordinary means of increasing their available capital ; but they would seek such advances from the Paper Currency Department only at periods of exceptional tightness of the money market. They recommended that the statutory minimum for the metallic portion of the Reserve should be 40 per cent of the gross circulation, which, it will be remembered, includes notes held in Reserve Treasuries. They also recommended that of the fiduciary portion of the Reserve not more than 20 crores should be held in securities of the Government of India.

It is interesting to observe how opinion has changed on this question of securities other than those of the Government of India being held as part of the fiduciary portion of the Reserve. It was in 1905, for the first time, that British Securities were allowed to be included in the Reserve, and the amount

allowed was only 2 crores. The limit was increased to 4 crores in 1911 and to 10 crores in 1916, and thereafter by rapid stages to 100 crores in September, 1919. The rupee securities which were increased to 20 crores in 1915 remained stationary at that figure till April, 1920. It has now become recognized that the sterling securities in the Paper Currency Reserve serve a very useful function, in that they may be used to replace or supplement the Gold Standard Reserve in maintaining the rate of exchange during a period of adverse balance of trade by being used for the payment of Reverse Councils as above described. This principle has a sound economic basis. When the export trade from India is brisk, the balance of trade is favourable ; and the demand for Councils is active. This places funds in the hands of the Secretary of State, and the Council drafts are paid in India by notes issued against the increase of the securities held in London. At the same time prices rise in India, partly from increased demand and partly from the increase of circulation.

There is a rise and fall of prices all over the world at the same time in a more or less regular succession of periods, which are usually seven or ten years in length. Such a period, whatever its length, is called a " cycle of trade. " In that portion of the cycle during which world prices are rising India experiences a favourable balance of trade. Immediately after world prices have commenced falling India begins to experience an

adverse balance of trade which lasts usually from twelve to twenty months. During these abnormal periods of adverse balance of trade Reverse Councils are sold and paid in London by selling the sterling securities of the Reserve. At the same time the money realised in India by selling the Reverse Councils is used to withdraw currency notes from circulation. This automatically contracts the circulation, if the amount of the rupee securities is fixed. The contraction of the circulation brings down prices in India, and re-establishes the favourable balance of trade at an earlier date than would otherwise have occurred. By this device of holding the greater part, and the elastic part, of the fiduciary portion of the Reserve in sterling securities, a perfectly automatic adjustment of the circulation to the state of trade can be secured. It also provides a means of maintaining exchange.

Paper Currency Act of 1920

The extraordinary measures which became necessary during the War for enlarging the fiduciary portion of the Paper Currency Reserve were admittedly a clumsy expedient for obtaining the necessary effect of elasticity. The expansion of the circulation was absolutely necessary and, as stated above, under the existing law no alternative course presented itself but to ask the Legislative Council to increase the portion of the Reserve that might be held in securities. The Finance Member of the time, Sir William Meyer, had begun by apologetically asking for an increase of the securities in the Reserve to 20

crores in 1915, and his successor ended by asking and obtaining sanction to a limit of 120 crores in September, 1919. The war-time Acts and the later one of April, 1920, were purely temporary, because it was fully realized that the old system of regulating the Reserve was obsolete and must be replaced sooner or later by a system having certain features of elasticity.

In framing the Paper Currency Act (1920) the Government of India adopted in principle the recommendations of the Committee ; but they preferred to impose upon themselves a somewhat higher standard for the metallic reserve and adopted 50 per cent instead of 40 per cent of the gross circulation as recommended by the Currency Committee (1919), although the power to issue 5 crores of notes against commercial bills of exchange in effect reduced this limit to about 47½ per cent. The permanent composition of the Reserve is to be as follows :—

(1) Metallic portion—to be not less in value than the securities portion of the Reserve ; (may include gold held by the Secretary of State not exceeding 5 crores).

(2) Securities portion :—

(*a*) Securities of the Government of India—to an amount not exceeding 20 crores valued at purchase price, of which not more than 12 crores may be " created securities " explained below) ;

(*b*) Securities of the United Kingdom the date of maturity of which is not more than one year from date of purchase.

(3) Bills of Exchange which will mature within 90 days, and which satisfy the conditions laid down by the Governor General in Council, to a total not exceeding 5 crores.

The metallic portion of the Reserve may consist of sovereigns, half-sovereigns, rupees, silver half-rupees, and gold and silver bullion. The gold bullion is to be valued at the rate of Re.1 for every 11.30016 grains of fine gold ; and the silver bullion at the purchase price converted into rupee currency. It will be observed that the token coins of nickel, and the subsidiary silver coins of 4 annas and 2 annas cannot be included in the metallic portion of the Reserve. Gold and silver coins other that those which are legal tender in India can of course be held in the metallic portion of the Reserve, but would be treated as bullion.

The function of the securities portion of the Reserve (with the bills of exchange portion) is to fill up the gap between the metallic portion of the Reserve and the gross circulation. At times when rupees come back from circulation the securities portion may decrease to any extent convenient. On the other hand, a maximum limit relatively to the metallic portion of the reserve is absolutely necessary in order to prevent any undue expansion of the circulation and to ensure the convertibility of

the notes. There is no rigid maximum limit except as regards rupee securities. British securities of short date may be held to any extent, subject to the limit that the total amount of securities does not exceed the value of the metallic portion of the Reserve.

It will be seen that this new Act provides the necessary elasticity. In a period of expanding trade and rising prices there is a demand for more currency. Let us suppose that the metallic portion of the Reserve was 75 crores and the securities 55 crores on a given date ; that there is an active demand for Councils ; and that with the proceeds the Secretary of State is buying sterling securities, and notes are being issued against them in India. A limit is fixed to the issue of notes in this manner when the total value of securities has also become 75 crores. The limit will be a smaller figure if in the meantime the encashment of notes has led to a reduction of the metallic portion of the Reserve.

It might appear that this latter contingency would seriously limit the increase of the note circulation against securities, such as is required during a period of active trade. But in the event of there being a heavy withdrawal of rupees or sovereigns from the Reserve, Government would immediately cable the Secretary of State to use some of the funds obtained by sale of Councils for purchase of silver (or gold) to be immediately shipped to India, where it would be coined and put in the Reserve. Thus the expansion of the circulation would only be delayed

by a few weeks ; and for every crore of gold thus imported, or for every crore of tolas of Indian standard silver imported (which at the prevailing price of silver would usually cost less than a crore of rupees), the Government of India could issue two crores of notes—one crore for the metal imported and another backed by the increase of the total of securities permitted by the increase of the metallic portion.

The provision that the securities of the United Kingdom shall be those which mature not more than one year after the date of purchase is a wise provision to prevent the loss which sometimes occurs on the realization of ordinary Government Loans. In former times it had been usual to purchase British "Consols," or War Loan stock which was not repayable until nearly 30 years thereafter. The price of such loans on the Stock Exchange is continually fluctuating ; and during the years 1910 to 1920 there was a continuous downward tendency of prices because the current rate of interest was rising. Consequently securities were sometimes sold at a loss. On the other hand, Treasury bills and securities which will be repaid within twelve months cannot fall much in value on the Stock Exchange, as they will be worth their full nominal value on the date of repayment.

The issue of currency notes against commercial bills of exchange originating in internal trade is now adopted for the first time in accordance with the recommendations of the Committee of 1919. The Royal Commission of 1913-14 had made a similar

proposal that Government should make loans to the Presidency Banks when needed. The small limit of 5 crores has been chosen admittedly as an experimental measure. When the manner of regulation of such issue has been tested by experience, if the effects have been found beneficial, as is expected, the limit will doubtless be raised. The idea of issuing currency notes against commercial bills is to secure an expansion of the circulation in a time of active demand for money. In years when the crops are heavy and merchants have to finance the movement of large quantities of grain, cotton, jute, etc., the demand for loans in the form of discounting bills of exchange is so great that the market rate of interest is forced up to 8 or 10 per cent, or even higher for a short period. Merchants do not like such a period of tightness of the money market. Sometimes they cannot get their bills discounted at all, and when they can the rate of interest is so high that it is very expensive to hold stocks of commodities.

The economic sequence is this : when there are very large stocks of commodities in the country there must be also a large volume of bills of exchange ; and therefore there is needed at that time a large volume of rupee circulation to be used in discounting the bills. The provision that notes may be issued against bills of exchange amounts, therefore, to Government undertaking that up to a certain limit it will discount commercial bills of exchange, or " rediscount " them, as it is called commercially, when one bank discounts bills handed on to it by

another which has discounted them for its customers. The actual mechanism of the new system will be that Government will issue notes to the Imperial Bank in return for bills of exchange deposited with the Controller of Currency ; and the latter will charge the Bank interest at a high rate, not less than 8 per cent. This latter provision is meant as a safeguard that this means of increasing the available money will only be used in times of real emergency. There is no intention that the Imperial Bank should make a profit out of the transaction ; it will simply increase its available funds in this manner whenever the market rate rises above 9 per cent. This may be called a normal figure at the busy season : the additional funds available will avoid an unusual and embarrassing tightness of the money market.

As the Finance Member explained in his speech introducing the Bill, it would not be possible to bring the new permanent provisions for the Currency Reserve into operation at once owing to the difficulty caused by the necessity of revaluing the gold and the sterling securities of the Reserve on the basis of Rs. 10 to the sovereign instead of Rs. 15. At the time of his speech*, the gross circulation, after having reached a maximum of 186 crores, had been reduced to 162 crores, against which the metallic backing was 93 crores ; and the balance of the Reserve, 69 crores, consisted of securities,

* 2nd September, 1920. See Proceedings, Imperial Legislative Council, Gazette of India, 18th Sept. 1920, Part VI, p. 1113.

the valuation of gold and sterling securities being on the old basis of Rs. 15. If the new composition of the Reserve and the new valuation of the sovereign had been immediately applied, the metallic portion of the Reserve would have been less than 50 per cent, or else it would have been necessary to make a drastic reduction of the circulation, which would have been disastrous in its effect upon trade. It was necessary therefore to make temporary provision for bridging over the period which would be needed to bring the Reserve into conformity with the new permanent basis. By the temporary Act of March, 1920, Government had power to hold securities to a total of 120 crores. This was now an unnecessarily large figure, and as a temporary provision it was enacted that the total of securities should not exceed 85 crores. But the real difficulty was how to fill up the gap formed by revaluing the gold and sterling securities at two-thirds of their former value. This was easily done as a temporary measure by authorising the Government of India specially to create securities and issue them to the Controller of Currency, such securities being valued at the market price of similar securities on the date of issue. These "created securities" would obviously amount, however, to far more than the limit of twelve crores permitted by the provisions of the Act. It was therefore provided that the excess should be reduced gradually by replacing them with sterling securities. There being no funds available im-

mediately to purchase a large quantity of sterling securities it was provided that interest derived from the securities in the Reserve should be applied as from 1st of April, 1921, to the reduction of the created securities, and that the Auditor General should every year grant a certificate of the amount of such interest and that it was so applied. Government undertook also that, as soon as the Gold Standard Reserve should amount to £40,000,000, the interest on its securities, which now goes to swell that Reserve, should all be appropriated to the credit of the Currency Reserve. There would be about £2,000,000 annually from interest on the securities in the Paper Currency Reserve ; and after a year or so nearly an equal amount available also from the Gold Standard Reserve. Thus it would be possible in the course of some four or five years to fill up the gap created by the revaluation of the sovereign at Rs. 10, and to bring into effect the permanent provisions for regulating the Paper Currency Reserve. The necessity for delaying the application of the new rule that the metallic portion of the Reserve may not be less than the amount of securities does not involve delaying the very useful provision allowing the issue of notes against bills of exchange to the limit of Rs. 5 crores, which, after the rules governing it have been settled, can be made use of when the occasion therefore arises.*

* Since the above was written the metallic portion of the Reserve has increased to more than 50 per cent of the circulation ; whilst the Gold Standard Reserve exceeded £ 40,000,000 on the 30th September 1921, and the interest is being applied in reduction of the created securities. In March, 1922, 2 crores of notes were issued against bills of exchange. The Finance Act of 1922 has postponed for two years the use of the interest of the P. C. R. as above described.

CHAPTER XIII

CHANGES DURING THE WAR

We have seen in the last chapter that the Indian system of currency and foreign exchange was permanently established before the War and was working in a perfectly satisfactory manner. A proof of the excellence of the system which Government had established lies in the fact that it withstood perfectly the shock of the outbreak of war. Confidence was suddenly shaken by universal apprehension as to what might happen in the future. The big financial houses of Europe also saw that they would immediately need to utilize all their capital in their own countries. They therefore called in moneys which were owing to them from all parts of the world. So many people were trying at the same time to send enormous sums of money to England and to France that it was impossible to find any means of sending it. The exchanges, after rising very high against these remittances to Europe, completely broke down; and it was only by the intervention of the British and French Governments that a serious financial panic was averted and the exchanges were gradually restored to a working condition.

Want of confidence and weak exchange

The Indian system of exchange was completely prepared to meet such a crisis because of the large funds which had been accumulated in the Gold Standard Reserve and were held in London. The trade conditions in the summer of 1914 were already indicating that the balance of trade was likely soon to turn against India ; for the sales of council bills in May, June and July of that year had already fallen to less than one-fourth of the sales in April. Immediately on the outbreak of the War, however, foreign firms in India wanted to remit large sums to London and elsewhere, and Indian merchants were required to pay immediately for goods they had imported. Reverse Councils were offered and were freely bought. Imports ordered before the War were still arriving in India during the next three or four months ; but the export trade was immediately reduced in volume. Germany and Austria formerly purchased a large proportion of our exports, particularly raw commodities, and their trade disappeared entirely. Moreover, the exploits of the " Emden " in September and October, 1914, prevented many ships leaving Indian ports. For these causes amongst others, the balance of indebtedness remained outwards for several months, and reverse Councils continued to be sold until towards the end of January, 1915, when normal conditions became more nearly re-established. The total sum of reverse Councils sold during this period of unfavourable balance of

trade from August, 1914, to January, 1915, was £8,707,000.

During the spring of 1915 the sales of Council bills by the Secretary of State increased. Exchange weakened again in June and reverse Councils were sold again for the next three months. In September the balance of trade turned definitely in favour of India, and by the end of the year the Secretary of State was selling Council bills to an amount not much below normal for that time of year. This does not mean, however, that trade was being carried on upon the pre-war basis. As a matter of fact, both the imports and the exports were reduced, partly because England could not now supply goods for us to import, and exports to the Central Empires were impossible ; whilst shipping difficulties also affected both imports and exports.

Other noteworthy features of the first year of the War were mainly the results of the shock caused to confidence in India by the outbreak of war, and of the recovery therefrom. The crisis caused panic-stricken demands for gold, for the encashment of currency notes, and for the withdrawal of Post Office Savings Bank deposits. The first noticeable result was that sovereigns disappeared entirely from circulation. Prior to August, 1914, sovereigns had been in circulation to a limited extent in parts of India, particularly in the North. Within a few days the gold coins, always more easily carried and buried than silver,

disappeared from circulation, being hoarded by innumerable native bankers and petty merchants. Marwaris sent great quantities back to their native villages to be buried ; but perhaps it was not only fear which prompted this action. Some may have realized that war would prevent the importation of more gold into India, so that the price would be certain to rise.

At the same time a great demand arose for the encashment of currency notes in gold, and so early as the 1st of August, four days before Great Britain declared war on Germany, the Government had to conserve its gold by refusing to issue less than £10,000 at one time to any person. As £1,800,000 of gold was withdrawn in four days, this restriction was practically ineffective ; and on August 5th, Government notified that gold would no longer be issued to private persons, a restriction which has ever since been maintained. The result was that sovereigns very soon rose to a premium, being quoted at Rs. 15-6-0 by the end of August and at Rs. 15-8-0 in November, 1914, although thereafter there was a temporary decline, before the premium rose to a much higher figure.

The demand for the encashment of currency notes was particularly strong in the Bombay Presidency. Government at once took steps to check any panic by issuing instructions that every endeavour should be made to meet promptly all demands for encashment at district treasuries, although a currency note was convertible as a

matter of right only at the head currency office of the circle of issue. The result was that the active note circulation, that is, amongst the people, remained practically stationary, whilst the gross circulation was reduced through the Presidency Banks considerably reducing their holdings, which had been unusually large just before the outbreak of War.

The deposits in the Post Office Savings Bank were about 24½ crores on the 31st of July ; but from the second week of August there was a heavy and excited run by Savings Bank depositors, to withdraw their funds, so that about six crores were withdrawn during August and September. Withdrawals continued for several months, and the total deposits held fell to 15 crores by the end of March 1915. Thereafter withdrawals due to want of confidence ceased, and deposits gradually increased again as shown in the following table :—

Deposits in the Post Office Savings Bank, India

	Rs. Crores.		Rs. Crores.
at July 31st 1914	... 24·5	March 31st 1918	... 16·6
March 31st 1915	... 14·9	March 31st 1919	... 18·8
March 31st 1916	... 15·3	March 31st 1920	... 21·3
March 31st 1917	... 16·6	March 31st 1921	... 22·8

Growing Favourable Balance of Trade

By October, 1915, the currency and exchange position had become normal again, except for the total absence of sovereigns from circulation. About this time there began to arise a great demand for India's raw products and food-grains in the Allied and neutral countries. Jute cloth was

required in huge quantities for sand bags, and hides were wanted for making leather for army boots and equipment. Indian cotton and various forest and plantation products were eagerly demanded. The exports of tea, indigo, lac, and wool all increased. At the same time the goods which India usually imports from Europe and America were difficult to obtain. As the total money value of the exports began to exceed that of the imports more and more, there came to be a large balance of payments in favour of India. Council Bills were sold on a considerable scale during the cold weather of 1915-16. During the whole of 1916 the demand for Council Bills was very keen and continued to grow until it reached an intensity unknown in pre-war days, except for very short periods.

The supply of Councils unfortunately was necessarily limited by circumstances over which Government could have no control. This statement will become clear if we examine the two principal reasons. In the first place, it must be remembered that the Secretary of State cannot sell a Bill in London payable in India unless he is sure that the Government of India have actual cash to pay it with on presentation. When Council Bills are being sold in great quantities in London, their payment causes a heavy drain on the Treasury Balances in India. In fact, it is not possible to sell Council Bills for payment out of the Treasury Balances beyond the Secretary of State's requirements for his normal expenditure in England,

except to quite a limited extent. There are three ways, however, in which the Government of India may be provided with additional funds for the payment of Council Bills drawn upon them. The first and most obvious is by buying silver in London with the money which the Secretary of State has at his disposal as the result of previous sales of Council Bills. This silver is shipped to India and there coined into rupees in the Mints of Bombay and Calcutta. The second method is to increase the paper currency circulation in India, Government paying the Council Bills by simply issuing currency notes. This is only possible, however, according to the Indian Paper Currency Law, by increasing the Paper Currency Reserve to the same extent as the circulation. Hence Government could not avail itself of this means of meeting the extra Council Bills until it had obtained sanction for increasing the invested portion of the Paper Currency Reserve which might be held in securities in London. This permission Government obtained by an Ordinance in January, 1916, which was confirmed by Act IX of 1916 of the Indian Legislative Council. The third method by which Government could obtain funds in India with which to pay the Council Bills was by borrowing in India from whatever source money could be raised. Government borrowed from the Presidency Banks from time to time ; but it was not until the great War Loans of 1917 and 1918 that considerable funds were placed at the disposal of Government by this method. In 1916,

therefore, Government had to rely mainly upon the first two methods. It purchased enormous quantities of silver—so far as it could purchase without seriously raising the price : also nearly 27 crores worth of currency notes were issued against an increase by a similar amount of the invested portion of the Reserve held in England.

Finance of Indian Army Abroad

These resources, however, were quite insufficient to meet the growing demand for the finance of exports from India, because Government had also to finance on a large scale what, from the economic point of view, must be called an " invisible export." I refer to the expenses of maintaining the Indian Army serving abroad. It will be remembered that the arrangement made with the British Government was that the latter should pay the whole cost of employing Indian troops on foreign service, and all Indian military expenditure resulting therefrom in excess of what the Indian Army would have cost if it had not been employed in the War. The expenditure incurred by the Indian Government which the British Government had therefore to reimburse was on a very large scale ; and the difficulty was that the British Government, having no funds out here, refunded the money by paying it to the Secretary of State in London. The Government of India, therefore, was paying out enormous sums in India for the training of recruits, employment of labour, purchase of food, fodder, and all kinds of munitions and equipment, for railway

transportation, and for chartering steamers. Much of the imported and newly-coined silver, and much of the enlarged issue of currency notes, had to be used to finance these expenses. The funds held by the Secretary of State in London grew correspondingly large. It is instructive to set side by side the figures of the monies received by the Secretary of State for the sales of Council Bills and for refunds of war expenditure for a number of years :—

	Sale of Council Bills. in thousands of £'s.	Net receipts from War transactions in thousands of £'s.
1913-14 ...	31,201	*Nil*
1914-15 ...	7,748	8,686
1915-16 ...	20,355	14,251
1916-17 ...	32,998	33,195
1917-18 ...	34,881	61,994
1918-19 ...	20,946	82,880
1919-20 ...	31,226	58,236
1920-21 ...	*Nil*	52,073

It will be seen that the net receipts from the British Government on account of War transactions grew rapidly until they largely exceeded the receipts from the sale of Council Bills. Thus it will be understood how the necessity of financing this war expenditure led to a great difficulty in providing funds for the ordinary export trade of private firms.

Control of Exchange

This difficulty of providing funds to finance exports produced important results affecting Indian trade, which are of great economic interest. Before the War, when the demand for Council Bills

became strong the Secretary of State had simply to put his minimum selling rate up to gold point (which used to be 1*s.* 4⅛*d.*) ; and it then became cheaper for most of the Exchange Banks to buy gold in London and ship it to India. During the war, however, the British Government practically prohibited the export of gold and none could be obtained for export to India. This did not matter much, however, until the end of 1916, as the Secretary of State had been able to maintain his usual practice of selling Councils to meet the full requirements of the buyers in London.

The situation which developed cannot be better described than in the words of the Committee on Indian Exchange and Currency (1919).* " During November (1916) the amount of the weekly sales increased rapidly, and in the first fortnight of December they exceeded £5,000,000. The rupee holding in the Paper Currency Reserve had then fallen to 14 crores, and though there was silver awaiting coinage and the Secretary of State had made large purchases, it was evident that the continuance of sales on this scale would endanger the convertibility of the note issue. To avoid this danger the Council Drafts sold by the Secretary of State were limited from 20th December, 1916, the weekly amount, which varied between 120 lakhs and 30 lakhs, being fixed from time to time mainly on a consideration of the rupee resources of the Government of India. The limitation of the amount of

*Report, pages 9-10.

Council Drafts at a time when the demand for remittance to India was exceptionally strong and no adequate alternative method of remittance was available led to a divergence between the market rate of exchange and the rate at which the drafts were sold. It also became evident that the remittance available might be insufficient to finance the whole of the Indian export trade, and it was essential that the exports required for war purposes should not be impeded. It was found necessary, therefore, to introduce certain measures of control. From 3rd January, 1917, Council Drafts were sold at a fixed rate, which at the outset was 1*s.* 4¼*d.* for immediate telegraphic transfers, and the sale was confined to banks and firms on the 'Approved List', which included the chief exchange banks and a few large purchasers of drafts. A little later these banks and firms were required to do business with third parties at prescribed rates and to apply their resources primarily to financing the export of articles of importance to the Allies for the purpose of carrying on the war, a list of which was drawn up by the Secretary of State. An appeal was at the same time addressed to other firms engaged in Indian trade to conduct their remittance transactions through the exchange banks."

If this arrangement had not been made, exchange would necessarily have risen above 1*s.* 4¼*d.* ; and in fact whilst the negotiations with the banks were in progress, in January, 1917, exchange did rise to 1*s.* 5*d.* for a few days.

The result of the scheme of Government control was to provide exporting merchants with means of financing the export of all goods of national importance. As regards other goods, exporters had little opportunity of discounting their bills unless they could provide "cover." By this is meant the provision of business for the exchange bank in the reverse direction. For example, in ordinary times a merchant in India who had just put on board ship goods of the value of, say, Rs. 12,000 would take the bill which he had drawn on the English buyer for this sum to an Exchange bank which would discount it. During the control period, however, if the goods shipped were not certified as being of national importance, the bank would refuse to cash his bill unless he was able, at about the same date, to remit money to England. If, for instance, he required to remit Rs. 11,000 to England and went to the bank with this order at the same time that he took his bill to discount, the bank would readily buy his bill because the drawer was himself providing the greater part of the funds required in India for discounting it. If the banks had refused to do business even when a man could provide "cover" for nearly the whole value of the bill he wished to discount, the result would have been simply that people would have avoided using the Exchange Banks, and would have settled their exchange transactions between themselves, or by means of private brokers, as was done before exchange banks existed.

Owing to the rise of prices in the belligerent

countries being much greater than in India, it was very profitable, however, to export goods not of national importance ; and consequently merchants tried every conceivable means of financing such exports. There arose a market in " cover " ; and exporters readily paid 3 to 5 per cent, and sometimes even up to 10 per cent, to anyone who could provide them with " cover." Speculation by buying cover " forward," that is three to six months in advance, was a later development when exchange became unstable from 1918 onwards.

The Absorption of Silver

We must now seek to understand what was happening in regard to silver : why the Indian demand for coined silver rupees was so enormous, and why the price of silver rose, and what effect this had on exchange. The following figures show the number of whole rupees coined in the mints of India during each year :—

Year.		Lakhs of rupees.[1]
1912	..	12,25
1913	..	16,20
1914	..	4,84
1915	..	1,53
1916	..	21,29
1917	..	26,66
1918	..	41,19
1919	..	42,76
1920[2]	..	10,89
1921[3]	..	1,15

[1] The amounts coined for Native States have been deducted from the figures as published in Statement IX of the *Report of the Controller of Currency* for the year 1920-21.

[2] Coinage was stopped in July.

[3] Recoinage of old light-weight rupees only.

It is obvious at once that an enormous absorption of rupees commenced in 1916. The coinage in the next year was even heavier, and constituted indeed a record, being greater than that of the exceptional year 1916. In 1918, however, the absorption became absolutely unprecedented, and the vast total of well over 4,000 lakhs of rupees was coined. In 1919, so far from the demand slackening off, there was even a further increase and a new record created, which it is to be hoped may not again be surpassed until many years hence. Indeed, it may be hoped, that as the people become progressively more and more accustomed to the use of currency notes, and gold comes perhaps actively into circulation, the demand for silver coins may never again become so great. In 1920, the demand for rupees slackened off under circumstances which will be explained in the next chapter.

The question with which we are now concerned is the sudden awakening of this huge demand for silver, and the course of the world's price of silver during the later years of the War. As will be explained more fully in a later chapter, the enormous absorption of rupees which began in 1917 is to be accounted for by the fact that prices in general were rising, as well as by the activity of the export trade and the extensive Government purchases for the Army. The prices which were paid for raw products exported from India were constantly rising, because prices in the countries at war were rising rapidly and they could afford to pay higher

prices to India. When the exporting merchants obtained higher prices, they gradually, by competition amongst themselves, raised the prices which were paid to the actual cultivators for their cotton, to the chamars who collected the hides, and the junglewallahs who collected forest products. Government was also paying the hitherto unprecedented wage rate of one rupee per day for unskilled labour. All these people were receiving more money than they had ever before handled—considerably more than they needed for their actual subsistence, because the price of food grains had not risen much in 1916 and 1917. The cultivators and labourers all insisted on having payment in silver rupees because they were not accustomed to currency notes, nor could these latter, they thought, be kept safely by burying underground. Consequently, many crores of silver rupees which were thus paid out to cultivators and labourers in all parts of India remained in their hands.

In normal times nearly all of the money thus paid out comes back to the banks and Government treasuries because the people have to spend the greater part of their earnings on purchasing food and all the miscellaneous requirements of life, such as clothing, oil, iron and brass utensils and so forth. But in 1916 and 1917 the prices of all kinds of cotton and woollen cloths were rising rapidly, and the price of iron and brass had also risen. People can if necessary make their clothes last longer than usual, and they can avoid buying brass lotas and dishes. People made up their minds that prices were too high, that they were being cheated by the

banias, and they decided to do without things rather than pay exorbitant prices. Probably most people expected that prices would go down as soon as the war was over, and decided to wait till then. The result was that they kept their money and the rupees did not flow back to the Government treasuries. This was the reason why Government had to make such large purchases of silver in foreign countries. The same kind of thing was happening also in other countries. Everywhere a great demand for silver was caused by the rise in prices, but unfortunately just at this very time the supply of silver which comes from mines in various parts of the world became much less than usual. This was mainly owing to the fact that the revolutions in Mexico were creating such disturbances that many mines were closed ; also in 1915 and 1916 the Mexican mines had difficulties in obtaining the cyanide used in recovering the silver.

The following figures show the quantity of silver mined in different parts of the world each year :—

Production of Silver from Mines.

(in fine ounces, 000's omitted).

Year.	Canada.	U. S. A.	Mexico.	Rest of World.	Total of World.
1910	.. 32,869	57,599	71,372	57,249	219,089
1911	.. 32,559	61,109	79,033	57,683	230,384
1912	.. 31,956	66,041	74,640	60,423	233,060
1913	.. 31,806	71,200	70,704	57,966	231,676
1914	.. 28,449	69,634	27,547	50,418	176,048
1915	.. 26,626	72,369	39,570	47,180	185,745
1916	.. 25,460	78,875	22,838	48,283	175,456
1917	.. 22,221	70,666	31,214	50,949	175,050

This falling off of the world's total production at the same time that Europe was engaged in war was very soon followed by the increase of demand above mentioned ; and the natural result of this was an increase of the price of silver. In 1916, the price began to rise, and in 1917 it rose more rapidly until in August, 1917, the price of silver in London was 46*d.* per ounce, and in September it went higher. When the rupee was valued at 1*s.* 4*d.*, the silver in the rupee became equal in value to this nominal value (1*s.* 4*d.*), when the price of silver reached 43*d.* per ounce. In other words, as soon as the price of silver exceeded 43*d.* per ounce, the rupee became worth more as bullion than as representing the fifteenth part of £1. When the price of silver reached 55*d.* per ounce, as it did on one day in September, 1917, the rupee was actually worth 1*s.* 8½*d.* as bullion.

Let us see what were the results of this. Obviously it would have been very profitable to export rupees. For example, any Indian merchant could collect, say, Rs. 10,000 in silver, put these on board ship properly packed, and sell the rupees in London as silver bullion, where at the price of 1*s.* 8½*d.* he would realise £854-3-4. Now with this money he would buy a bill on India at the rate of 1*s.* 4¼*d.*, which was the rate of exchange then prevailing, and by cashing this bill in India he would draw Rs. 12,615-5-0, and he would thus have made a profit of Rs. 2,615-5-0, less the cost of packing, freight, insurance, etc., which might be about Rs. 250.

Early in September, 1917, Government therefore prohibited the export of silver coin and bullion from India ; and it prohibited import by private persons also, so as to facilitate the purchase of silver by Government for coinage purposes. The rise in the price of silver had also made it more profitable to melt up rupees than to purchase silver bars, and this led Government to prohibit the melting of silver and gold coin. The most important result, however, of the rise of the price of silver was that Government was forced to raise the rate of exchange on London. Had the exchange remained at 1*s.* 4¼*d.*, much silver would probably have been smuggled out of the country in spite of the prohibition ; but a still more serious difficulty would have been the loss which the Government would have incurred in having to buy silver at an average cost of, say 1*s.* 6*d.* for the rupee, whereas when that rupee was sent to India and paid out there it was only worth 1*s.* 4*d.* to Government. In August, 1917, therefore, the rate of exchange was raised to 1*s.* 5*d.*, at which figure it remained until the following April.

The Silver Crisis and the Pttman Act.

Meanwhile the Government of India was seeking some new source for the supply of silver. The Secretary of State had purchased so heavily during 1916 and 1917 that the Indian demand had largely contributed to the rise of the price of silver. It was obvious that a continuance of buying in the open market would simply mean that Government

was raising the price against itself. Knowing that the Government of the United States had in its treasury an enormous reserve of silver dollars, accumulated from the silver purchased under the Sherman Act of 1890,* the Government of India approached the United States to sell some of this large reserve. They were able to point out that the balance of trade between India and the United States was strongly in favour of India and that with the strictly limited resources available for financing exports from India it would be convenient to have the balance settled by the shipment of gold or silver. The United States came to the assistance of India in a most liberal manner. The so called Pittman Act was for this purpose passed through Congress in April, 1918, and it gave the American Government power to sell the silver in the reserve to a total amount of 350 million dollars, worth over 100 crores of rupees. The Government of India purchased out of this 200 ounces of pure silver at 101½ cents per ounce fine. The silver in the Indian Paper Currency Reserve which in the summer of 1917 stood at over 28 crores had fallen rapidly during the cold weather of 1917-18, until at the end of March, 1918, it had fallen to less than 11 crores, including silver bullion under coinage. The position then became rapidly more serious. A crisis developed in Bombay, and a run on the Currency Office began which very soon spread elsewhere. The events cannot be better described than in the words of Mr. Gubbay, then

*See pages 125 and 131.

Controller of Currency.* "The storm centre was in Bombay. On the re-opening of the Currency Office in April after the Easter holidays the silver balance at Bombay stood at 130 lakhs. Within three days this balance was reduced to 19 lakhs and it was clear that a crisis was imminent. It was staved off solely by the magnificent co-operation of the Mints and by the rapid transfer to that office of such surplus rupees as could be made available from Bengal and Central Provinces. Within six days no fewer than 187 lakhs were despatched from these areas to Bombay, while special measures were adopted at the Bombay Mint to accelerate the deliveries by dispensing with formalities. Simultaneously, however, difficulties arose in Madras and Rangoon. The former Currency Office closed on the 12th April with a balance of 1 lakh of silver after having issued 4 lakhs worth of sovereigns. In Rangoon actually on the same date one tenderer was refused silver. At both these places the situation was saved by the closing of offices on account of local holidays which rendered it possible to collect for issue thereat rupees lying at Treasuries and sub-Treasuries. At Calcutta, however, there was fortunately no trace of any abnormal developments."

This exceptional demand for silver was doubtless due to the requirements of those engaged in financing the cotton crop. The merchants came personally long distances from small moffussil towns to

*See his Report for 1918-19, page 19.

Bombay with thousands of rupees worth of currency notes, and waited from opening till closing time day after day in the crowd struggling to get into the Currency Office. Rumours that silver was running short got abroad, and this brought a large number of persons tendering comparatively small amounts of notes. The public excitement in Bombay was relieved by the issue of a communiqué on 15th April referring to an Ordinance just promulgated which made it possible for silver purchased in America and in transit therefrom to be included as bullion in the Paper Currency Reserve. Four days later it was definitely announced that legislation had been introduced in America to permit the purchase by India of part of the American Silver Reserve. From this date the panic demand for rupees which had begun to develop disappeared ; but there remained a steady continuous drain on the silver in the Reserve. There was much relief, therefore, when it was announced that the Pittman Act had been passed and that large quantities of silver would reach India within three or four months. The drain on the Currency Reserve continued and the silver coin in India, including silver bullion under coinage, had fallen to 5 crores and 90 lakhs by the end of May. The lowest point reached was a week later when little more than 4 crores remained. Thereafter the arrivals and coinage of silver began to overtake the demand, and the silver portion of the Reserve slowly increased. It may seem that the amount

of 4 crores 14 lakhs which was the lowest actually touched was still large ; but it must be remembered that the active circulation, that is to say, the total notes outside Government treasuries and head offices of Presidency Banks, amounted to over 90 crores, and that the four crores of actual silver coin in the Currency Reserve was scattered about in various Currency offices and currency chests ;* so that whilst in some circles there was still enough silver to meet the demand for the encashment of notes, in others there was a serious deficiency. This necessitated restrictions on the encashment of notes, only very limited amounts being convertible at one time. In some parts of India, therefore, and particularly in the cotton-growing districts of Berar, Khandesh and Gujarat, notes fell temporarily to a considerable discount, from 3 to 5 per cent being common, whilst figures such as 10 and 15 per cent were reported here and there.

*See Chapter XII, page 163.

CHAPTER XIV

AFTER THE WAR

In the last chapter we followed the changes in the Indian currency and exchange which took place during the war. We saw that the great demand for India's exports, and the military expenditure, led to a great issue of rupees to the public, and that owing to the very high prices of manufactured articles these rupees did not go back to the Government treasuries in the normal manner, but remained in the hands of the cultivators and labourers. For this reason the Government of India had to purchase enormous quantities of silver in England and America, and the rate of coinage of rupees at the Indian mints became far greater than was ever known before. As a result of the shortage of the world's production of silver, followed by a great demand from many countries, the price of silver rose considerably, and this necessitated the raising of exchange, until at the time of the Armistice (November, 1918) it stood at 1*s.* 6*d.*

The three years which have elapsed since the end of the fighting have been an eventful time in the history of Indian currency and exchange. The conclusion of the Armistice did not bring any sudden change in economic conditions. In all the belligerent countries governments were still spending on a huge scale from borrowed moneys ; the

inflation of the circulation continued, and so did the rise of prices. For various reasons the exchanges between the principal countries of the world fell into a condition more chaotic than they had been at any time during the war after the first shock in 1914. So, if India has had her embarrassments in exchange since the war, she has only suffered in common with every other civilized country.

If we examine the history of the Indian exchange during the past three years (November, 1918), till October, 1921, we find that it can be divided into three periods in accordance with the predominating factor in determining the rate of exchange at the time, one of these periods being very brief. In the first period the price of silver was still the predominant feature of the situation ; in the second period the principal factors were the new policy adopted as a result of the Report of the Committee on Exchange and Currency published early in February, 1920, and the depreciation of sterling money in relation to gold ; whilst in the third period the predominating factor has been, and at the time of writing still is, the adverse trade balance. The first of these three periods will be considered in this chapter, and the other two in the next chapter.

In the first period, at the conclusion of the Armistice, the trade balance was still highly favourable to India. The huge war demand for Indian grown products continued for a few weeks ; and as this died down afterwards through the cancellation

of Army contracts, an even greater demand for raw products arose for various purposes. Manufacturers in Europe and particularly in America had to meet a huge demand for replenishing stocks of the manufactured goods of peace time, and to manufacture these they had to replenish their depleted stocks of raw materials. They were willing to pay fancy prices for Indian cotton, hides, lac and many other products. On the other hand, it was still practically impossible to obtain imports of the various descriptions which India needed ; consequently there was far more to be paid for the exports than we had to pay for our imports and the balance of trade was very favourable. This meant a keen demand for Councils ; but the supply was limited because the British Government was still maintaining a large Indian Army in foreign parts and refunding the cost to the Secretary of State in London.

India therefore was in a position to absorb the enormous quantities of silver now arriving from America as a result of the purchase made under the Pittman Act. Trade was brisk in India and prices were rising. The silver position caused no further anxiety as regards the convertibility of the notes, because the quantities arriving, which were coined by the prodigious efforts of the mints, were more than sufficient to meet the continued absorption by the public.

It was the rising price of silver which became the disturbing factor. From November, 1918, until May of the following year the price of silver remained fairly constant in London at about 48*d*. per

ounce. Thereafter it commenced rising, and reached 55½*d.* in July, 61*d.* in August and 64*d.* in September, 1919. In October it touched 66½*d.* ; in December 79⅛*d.* The reasons for this extraordinary rise cannot be fully discussed here. Doubtless the main causes were the re-awakening of the industrial demand for the manufacture of jewellery and articles of all kinds in the belligerent countries, the continued absorption of silver for currency in China and other countries owing to the rising prices, and furthermore, as regards the price in England, the depreciation of sterling money, the effect of which is explained later in this chapter. The result of the rise of the price of silver was the raising of exchange by successive steps. This was necessary in order to protect the Indian silver currency, and to avoid loss in purchasing silver for coinage, as explained at the end of the last chapter (see page 205). The following table shows the dates upon which the rate of exchange was raised, and the price of silver in London on the same dates. The figures given in the middle column are the minimum rates at which the Secretary of State offered for sale immediate Telegraphic Transfers, that is to say, the telegraphic form of Council Bills.

Date of Change.	Rate of exchange.	Price of silver in London.
	£ s. *d*	*d*
12th April 1918	0 1 6	46¼
13th May 1919	0 1 8	55½
12th August 1919	0 1 10	58¾
15th September 1919	0 2 0	59
22nd November 1919	0 2 2	74
12th December 1919	0 2 4	78¼

There is nothing worse for foreign trade than a fluctuating rate of exchange, as this provides many risks and uncertainties which have to be faced by the merchants. The Indian exporter generally sells goods for export in terms of foreign money—pounds sterling or dollars—and, when the goods have been put on board ship, and he takes the bill which he has drawn to an exchange bank to discount, the rate of exchange prevailing at the moment is of vital importance to him. If exchange has risen since he made his bargain, he will get fewer rupees for his pounds or dollars than he estimated, and will thereby suffer a loss. It is true that, as regards single transactions, the merchant can protect himself to a great extent by buying "cover" beforehand from an Exchange Bank, or broker; but he has to pay something for this. The most serious risk, against which no provision is possible, arises from the fact that many transactions become altogether unprofitable with a rise or fall of exchange, so that the normal course of the merchant's business is interrupted or made highly speculative. For example, when exchange falls, goods imported from England or America will cost more in rupees in India, assuming the price abroad remains the same. An importer of piece-goods, or other commodities, must place his orders months beforehand if he is to be sure of any stock to do business with. Suppose he has just received and paid for large stocks and exchange rises. His competitors will obtain supplies paid for at a higher exchange rate, which is equivalent

to a lower price, and they will be able easily to undersell him. On the other hand if he has allowed his stocks to run low, and when he receives his new consignments from abroad exchange has just fallen, that is equivalent to a rise of price, and he finds his competitors still selling large stocks paid for when exchange was higher.

Similarly, the exporter finds that even at his lowest prices foreign buyers tend to hold off altogether when exchange rises high ; so that the volume of demand for the exporters' goods fluctuates violently with the rate of exchange. Yet the exporter is obliged to make commitments in advance in the way of buying his cotton, wheat, oil seeds, hides or other commodities several months before the actual time of shipping. The fact is that as a result of a fluctuating exchange many losses are incurred in foreign sales and purchases which would otherwise have been profitable ; and the knowledge of this risk causes merchants to abandon all transactions, except those appearing likely to yield a large margin of profit. In normal times with a stable exchange a considerable part of the total foreign trade is carried on with a comparatively small margin of profit ; consequently an unstable exchange destroys much trade. It will be easily understood, therefore, how important it is for the benefit of the country's trade to secure by some means the advantage of a stable exchange, such as India did, in fact, enjoy from 1898 till 1917.

Having these considerations in view, and because

a new set of conditions had arisen with silver prices so high, Government felt that it was desirable to have the position of the Indian exchange and currency system reviewed by a body of expert opinion. In May, 1919, therefore, a Committee was appointed of which Sir Henry Babington-Smith was Chairman, consisting of several gentlemen having great experience of business and finance, to report as to any permanent changes which should be made in the Indian currency system. The Report of the "Committee on Indian Exchange and Currency, 1919" as it was called, will be described later in this chapter. It is necessary first to notice a new factor in the currency and exchange situation which developed in the summer of 1919.

Depreciation of English sterling money

This new factor was the depreciation of English sterling money with reference to gold. By "sterling money" is to be understood the English paper currency, consisting of treasury notes and bank notes, chiefly those of the Bank of England, and all bank deposits and commercial documents, convertible on demand into legal tender money. The Treasury and Bank of England notes, being unlimited legal tender and being obtainable in any desired quantities, form the actual currency of the country; and the Bank deposits represent these notes. Before the war Bank of England notes were always convertible into gold at par, and all banks were under legal obligation to pay cheques with sovereigns, if demanded. At that time, therefore,

English sterling money and gold meant the same thing. The great rise of prices in England and the need of munitions from America tended strongly to drive English gold abroad, and much actually left the country during the war. At the same time that the paper currency circulation and bank deposits were greatly increasing, the stock of metallic money in the country was becoming proportionately much smaller. Therefore it became necessary for Government to control dealings in gold. The melting of sovereigns was most strictly forbidden and penalised, and export of gold from the country was made practically impossible by refusal to insure gold except when shipped for purposes of national necessity for securing imports. The banks in England at the same time co-operated with the Government to prevent sovereigns rising to a premium above paper money.

The essential part of this policy of control was the fixation of the rate of exchange between London and New York.* The par of exchange is $4.87 to £1 ; and before the war the outward gold point from England was $4.82. During the war the cost of shipping gold greatly increased owing to the rise of freight rates and the high charges for insurance. Consequently the outward gold point fell to about $4.76½.† The British Government arranged with

* The rate of exchange between London and New York is spoken of in India as the "American Cross-rate," or as the "New York Cross-rate." A "cross-rate" is the rate of exchange between any two places outside one's own country.

† In other words the cost of the dollar rose from 4*s.* 1½*d.* to 4*s.* 2¾*d.*

the American Government to fix, or "peg" the exchange approximately at this figure.* Doing this involved big loan transactions between the two Governments and the co-operation of the big banks.

It is obvious that such manipulation and control of the exchange could not be continued indefinitely after the end of the war, for to have done so would have involved one or both the Governments in heavy financial commitments. Government support of the exchange was withdrawn, therefore, in March, 1919; and since that date the London-New York exchange has moved freely in accordance with the conditions of the supply and demand for remittance in both directions. The dominating factor has been the heavy balance of trade against England, which means that if enormous quantities of gold had been available in England, these would have been shipped to America; and this would have kept the exchange from falling below $4.76. If England had sent all the gold in her central reserve—the Bank of England, probably it would not have sufficed to keep the exchange up to the gold export point; and as gold was not available for export, people wishing to remit to the United States competed against one another to buy dollars, until the price of the dollar rose considerably. In other words, the rate of exchange (the number of dollars obtainable for £1) fell heavily. In August, 1919, it stood at $4.20 and by December 23rd had fallen to $3.83.

*The actual figure was $4.76 7/16.

Soon after the London-New York exchange was "unpegged," the British Government allowed a free market in gold to be re-established in London for dealing with such supplies as might be imported into England. The price of gold in London rose therefore to the same extent as the London-New York exchange fell; for, obviously, until the price of gold had so risen it would be profitable to buy gold in open market in London and ship it to New York, and this was done in limited quantities. It is easy to determine what the price of gold would be in London at any time by the following equation, in which the figure 77*s.* 10½*d.* is the "mint" price of gold in England—in other words, the number of sovereigns which are coined from one ounce troy (480 grains) of standard gold :—

$$\text{Price of gold in London} = \frac{4{\cdot}87}{3{\cdot}83} \times (77s.\ 10\tfrac{1}{2}d.) = 99s.\ 0\tfrac{1}{4}d.$$

In reality the price of gold will be a shilling or two above or below the figure calculated above, according to whether the state of demand for gold in London is such as to lead to its being either imported from America, thus adding the cost of transport to the price, or exported to America, the cost of transport being thus subtracted from the price. Anticipation of the probable rise or fall of the New York cross-rate also has an effect on the price of gold in London : as in the summer of 1920 when it stood considerably above the parity determined by the exchange equation as above, owing to the anticipation, which proved correct, that exchange would fall in the early autumn.

It may be added that a similar equation governs the prices of all commodities in England which can be imported from America, or exported thereto, at a comparatively small cost in freight charges. Of special interest in this connection is the price of silver in London. Most of the silver sold in London comes from America (including Canada, Mexico and South America, whose rates of exchange do not differ greatly from the New York rate). The price of bar silver as usually quoted in London is the price in sterling money, not in gold. Consequently the price of silver in London is governed by the above equation of exchange ; and as the New York cross-rate falls so does the price of silver in London rise.

REPORT OF EXCHANGE AND CURRENCY COMMITTEE*

The terms of reference to the Committee directed them to make recommendations with a view "to ensuring a stable gold exchange standard." The Committee were thus precluded from considering

*Everyone wishing to study the evidence submitted to the Committee along with their Report should obtain the following four volumes : (I) The "Report of the Committee" ; (II) "Minutes of Evidence," which consists of the verbatim shorthand notes of questions and answers of witnesses ; (III) "Appendices" which prints the written memoranda submitted by the various witnesses, including the Government of India, and tables of statistics ; and (IV) the "Index" to Volumes II and III, which is a great convenience for the purpose of tracing the statements in evidence and memoranda on any particular subject. These volumes are published by His Majesty's Stationery Office in London, and the reference numbers are : Cmd. 527 528, 529 and 530 respectively.

the question of returning to a single silver standard, or introducing a bi-metallic standard ; but they commenced their report by stating that no useful end would have been served if their reference had permitted the consideration of these alternatives. There follows next in the report a brief description of the position of the Indian currency and exchange at the outbreak of the War, which serves as an introduction to a history of the principal changes and events relating to currency and exchange during the period of the war and subsequently. This is concluded by a summary of the position as it existed at the time the Committee ended its sittings ; and the report then proceeds to the Committee's conclusions and recommendations. In the opinion of the Committee " the system built up since 1893 worked well, and was beneficial to India. It supplied suitable media for the internal circulation, provided means for the settlement of the balance of trade, and secured stability between the rupee and sterling, which until recently was in practice synonymous with gold. It has proved effectual in preventing the fall in value of the rupee below 1*s.* 4*d.*, and unless there should be profound modifications in India's position as an exporting country with a favourable trade balance, there was no reason to apprehend any breakdown in this respect."

" But the system was not proof against a great rise in the value of silver. In framing it, this contingency had not been taken into account. So little was it anticipated, that the system was not criticised

on this ground, so far as we are aware, by any of the witnesses who have appeared before the successive Committees and Commissions on Indian currency. But the unexpected has happened."

The Committee then proceeded to give their reasons for attaching great importance to stability of exchange ; but they were of opinion that the price of silver was unlikely to fall again to the low level at which it stood before the War, at any rate for many years, owing to the present high cost of mining, and the undertaking by the United States in terms of the Pittman Act to purchase silver mined or refined in the United States at one dollar per ounce. Even when the dollar-sterling exchange should return to par, silver at one dollar per ounce in the United States would involve the rupee being fixed at not less than 1*s.* 6*d.* A price of silver corresponding to one dollar per ounce might be regarded as the probable minimum ; but it was more difficult to fix a maximum. It was, however, probable that the price could not rise for long above a level which would be sufficient to induce the public to melt up silver coins of their countries or the Governments to convert their large reserves of silver coins into gold. Thus in the case of the silver coins of the United States the bullion value becomes equal to the nominal value at the equivalent of the price of 59¼*d.* per ounce in London, and the bullion value of English silver coins equals their nominal value at 66*d.* Consequently it is not likely that the price of silver could remain for a long period much above

66*d.* per ounce. It may be noted, however, that this protection, so far as the currencies of England and France are concerned, has disappeared, since the fineness of the English silver coins was reduced in 1920 from 92.5 per cent to 50 per cent, and similar action has been taken in France. The United States has, however, a large reserve of dollars, and these are still coined at their old standard of fineness. Consequently for some years the price of silver seemed likely to be limited in its fluctuations between the minimum of 48*d.* per ounce imposed by the American purchase law*, and 60*d.* (gold) per ounce imposed by the melting point of the dollar. The Committee pointed out that if the rupee exchange were to be stabilised at 2*s.* in terms of gold, the melting point of the rupee would be approximately 63*d.* per ounce ; and thus there would be reason for believing that the rupee could be established as a token coin at this rate. The currency system would, in fact, be proof against any probable rise of the price of silver.

It might be argued, however, that although it was desirable on general grounds to fix a rate of exchange as high as 2*s.* in order to put the Indian currency system on a footing with the systems of Europe and America as regards protection against a possible rise of the price of silver ; yet such a high level of exchange might be prejudicial to the

*In spite of the apparently sound reasons above stated the price of silver has already fallen much below the minimum prescribed by the undertaking to purchase American mined or refined silver when the price falls below one dollar per ounce. The present price (December, 1921), is about 35*d.* per ounce. See also Table of Prices of Silver in Appendix I.

economic welfare of India. Consequently the Committee proceeded to consider this question. They had before them the statistics showing the rise of prices which took place during the five years from 1914 to 1919—figures which will be found in a later chapter of this book.* They pointed out the very serious effects which the general rise of prices was having in India, and the great hardships caused to the millions of the poorer classes. The wages of manual labourers, which are practically at subsistence level, had been already to some extent re-adjusted ; but the re-adjustment of the remuneration of the clerical and other fixed salaried employees would necessarily be a slow and painful process. The relation between the price level in the country and the rate of exchange is such, that prices outside the country multiplied by the rate of exchange will be equal to the prices within the country. Obviously, therefore, the high rate of exchange which had already been achieved in 1919 was tending to check a further rise of prices ; and if the exchange rate were to be lowered again, a further considerable rise of prices in India must be expected. It was also pointed out that whilst a rising exchange stimulates the import trade and temporarily damages the export trade, the maintenance of exchange at a high level could not tend permanently to damage Indian trade or industrial development in India. So long as exchange was kept stable at the high level, prices and the cost of production in

*See especially, page 265.

India would adjust themselves to the new level and trade would be as extensive and prosperous as before. The reasons for this will be found in the last chapter of this book. It was further pointed out that the cost of remitting the Home Charges, amounting to £25-millions, would be 37½ crores with exchange at 1*s.* 4*d.* but only 25 crores if exchange were fixed at 2*s.* On the other hand, there would be a loss involved in re-valuing the gold held in the Paper Currency Reserve and the sterling investments held in London. "If the whole of the revenue saved in respect of the Home Charges could be employed for the purpose of meeting this loss, it would be recouped in about three years. Thereafter a considerable surplus revenue would remain."* This, however, was admittedly an argument of no great weight in comparison with the broad question of the general level of prices and the prosperity of Indian industry and trade, which merited, and did receive, the fullest consideration.

The Committee proceeded to consider whether the rupee should be fixed in relation to gold or to sterling, and decided in favour of the former. The late Mr. Lucas, financial Secretary of the India Office, strongly advocated this course in his evidence before the Committee. He was of opinion that the linking of the rupee with the depreciated sterling currency would be unjust to India, because, if sterling depreciated further, prices in India must rise correspondingly. The only alternative would

* Report, paragraph 53, page 23.

be again to alter the exchange rate, thus entailing all the evils of instability. In his opinion stability of exchange was immediately attainable with all countries whose currency was still on a gold basis, namely, America, Holland, Japan and some of the British Colonies, at 1*s* 10*d*. gold. The extent to which his anticipations have been realized in the following eighteen months will appear later.

The Committee adopted these suggestions, which were supported by other witnesses, but on the 2*s*. basis. They recommended that a suitable relation should be established with gold and not with sterling, and that the gold equivalent of the rupee should be sufficiently high to give assurance that the rupee in its present weight and fineness would remain a token coin. With the exception of one member, the Committee were unanimous in recommending that the rate for the establishment of this "suitable relation" between the rupee and gold should be Rs. 10 to one sovereign, or in other words, at the rate of Re. 1 equivalent to 11.30016 grains of fine gold both for foreign exchange and internal circulation.

The other recommendations of the Committee, except as regards Paper Currency, are subsidiary to this decision fixing the rupee in relation to gold at 2*s*. The steps which they recommended for bringing the new rating of the rupee into force have since mostly been executed, and the action taken will be described in the next chapter. Furthermore, they recommended freeing the import

and export of silver and gold from all restrictions at the earliest date practicable. They also recommended retaining in a permanent form the increased facilities for the investment of their savings by small investors through the Post Office which had been established during the War.

The recommendations of the Committee as regards the Paper Currency Reserve have already been explained in a previous chapter.* It will be remembered that the two principal changes proposed were both intended to give greater elasticity to the paper currency circulation ; and with this object they recommended that an indefinite amount of notes might be issued against securities, so long as the metallic reserve was maintained at a minimum equal to 40 per cent of the gross circulation ; and further that an experiment should be made in issuing notes against the security of bills of exchange up to a limit of 5 crores.

As regards the Gold Standard Reserve, their recommendation was that the invested portion should normally be held in sterling securities in London where funds are required to meet Reverse Councils ; but a portion of the Reserve should be held in gold, of which a part, not exceeding one-half, should be held in India, precautions being taken to make it available to the public only for the purpose of export from India.

A separate report was made by Mr. D. M. Dalal, which contains several observations of interest. His principal proposals were that the hitherto prevailing rate of Rs. 15 = one sovereign should

*Chapter XII on Reserves and Balances, pages 175-178.

remain unchanged, and that as long as the price of silver in New York should be over 92 cents (which corresponds with the bullion value of the rupee when exchange is at 1*s.* 4*d.*) Government should not mint silver rupees of the existing standard of fineness, but should issue only two-rupee silver coins of reduced fineness and eight-anna silver pieces of reduced fineness. The last proposal has been condemned almost unanimously by public opinion, owing to the impracticability of having the two-rupee coin of reduced fineness in circulation along with rupees. The two-rupee coin would tend to fall to a discount—at times considerable—the extent of which would depend upon the availability of supplies of bar silver in the bazaar and its price. A still greater objection to Mr. Dalal's proposals involving the return to the old exchange rate of 1*s.* 4*d.* was that it would probably mean a further advance of prices in India.*

In the next chapter we shall see what was the immediate action taken in connection with the publication of the report, and what was its effect upon exchange ; and we shall see what further steps were taken during 1920 to put into force the recommendations of the Committee. The peculiar effects of the serious unfavourable balance of trade which developed during 1920 will be dealt with ; and it will be seen that this unexpected economic situation unavoidably postponed the full realization of the Committee's proposals.

* The low exchange of 1921 did in fact maintain prices at a high level in India, whilst they were falling in the rest of the world.

CHAPTER XV

CURRENCY AND EXCHANGE IN 1920

The Report of the Exchange and Currency Committee was dated the 22nd day of December, 1919. The Committee had been sitting through the summer and autumn of that year ; and whilst they were sitting the export trade from India continued brisk and there was a strong demand for Councils, which only weakened somewhat towards the end of the year, partly perhaps as the result of the successive increases of the rate of exchange prompted by the rise of the price of silver.

In January, 1920, a definite change in the balance of trade became evident : the demand for Councils fell to a low level and exchange weakened—that is to say fell below 2*s.* 4*d.* There was a demand for Reverse Councils and these consequently were offered. Reverse telegraphic transfers were sold in January at 2*s.* $3\frac{29}{32}$*d.* to the amount of £5,394,000.

On February 2nd, 1920, the Report of the Committee on Indian Exchange and Currency was published in India and simultaneously there was issued a series of important notifications, which were the

first steps towards realising the recommendations of the Committee. The first notification was (1) that the acquisition rate for gold imported under license into India, which had hitherto been subject to variation as notified from time to time, would in future be fixed, and the rate of acquisition would be Rs. 10 for one sovereign or one rupee for 11.30016 grains of fine gold. Four other important notifications were : (2) That Council drafts and telegraphic transfers would be offered for sale weekly by competitive tender with no fixed minimum rate ; and that in future Reverse drafts and telegraphic transfers would be offered in India, when occasion so required, at a rate based on the sterling equivalent of the price of 11.30016 grains of fine gold as measured by the prevailing sterling-dollar exchange, less a reduction representing the cost of remitting gold ; (3) that the undertaking to issue Rs. 15 for every sovereign and Rs. 7½ for every half-sovereign tendered at a Reserve Treasury or Mint was cancelled ; (4) that the prohibition of the import of silver (but not export) was withdrawn, and the import duty of 4 annas per ounce was abolished ; (5) that the notifications prohibiting the melting of gold and silver coin and dealing therein at a premium were cancelled.

The effect of the second of the above notifications, that relating to the sale of Councils and Reverse telegraphic transfers, may not be clear at first

sight as it is expressed in technical language. Bearing in mind the depreciation of sterling money relatively to gold in England, it will be seen that it was intended that exchange should be regulated on the basis that Rs. 10 would buy one sovereign, and *vice versa*. It was assumed that the price of gold in London would be regulated by the American cross-rate*, which is approximately true. In London the price of Councils would be raised by competitive bidding to the figure at which it became profitable to ship gold to India instead of buying Councils. The price of a sovereign in London is given approximately by the following formula :—

$$\frac{4.867}{\text{American cross-rate}} \times 20s.$$

In February, 1920, the cross-rate fell to $3.35 making the price of one sovereign in England about 29*s*. The cost in London of one rupee in India would therefore be $\frac{29}{10}s$. *plus* the cost of transport of gold from London to India, say, $\frac{1}{4}d$. per rupee. In other words with the American cross-rate at $3.35, Councils would sell at a trifle over 2*s*. 11*d*. The rate for Reverse Councils was to be found by the same calculation, but deducting the cost of carriage, which would give 2*s*. $10\frac{5}{8}d$. The highest figure at which reverse telegraphic transfers were actually sold in February was 2*s*. $10\frac{27}{32}d$. The rate of Reverse Councils was theoretically

*See page 217, footnote.

intended to represent the effect of taking one sovereign, which under the new system theoretically represented Rs. 10 in India, from Bombay to London and selling it there for sterling money in the open market. From the price of the sovereign realised in London would only be deducted the cost of transporting it thither ; and dividing this price by 10 we have the theoretical outward gold point which was the rate fixed for the sale of Reverse Councils.

On the date of publication of the Report the American cross-rate was cabled at $3.65. Calculation immediately showed that the rate of exchange must rise considerably under the new system if the American cross-rate remained at its present figure. Consequently there was a wild rush of Indian exporters to sell their bills to the Exchange Banks before the rise should actually take place. This competition to obtain payment for exports at the lowest, and thus the most favourable, exchange rate, served very quickly to force up the rate of exchange, so that in three days it had risen to 2*s.* 8½*d.* It so happened that a few days later a most unexpected fall of the New York cross-rate took place ; consequently the rate for the sale of Reverse Councils had to be correspondingly raised. An unprecedented crisis in exchange developed. Bewildered exporters discounted their bills at higher and higher prices and the market rate of

exchange reached 2*s.* 10¼*d.* on February 11th.

Thereafter a reaction very quickly set in. The rush of exporters realising their bills came to an end and a new rush of remittances to England arose for the purpose of taking advantage of the unusually high rate of exchange. Commercial firms and private persons having free capital in India or intending to remit at any time in the near future took this opportunity of sending their money. A boom in company flotation had been in progress in India for some months and many of these companies being of an industrial character required plant from England, and they remitted the cost in advance. Besides, it was anticipated by many that exchange could not remain very long at this high level, so that undoubtedly a great deal of speculative remittance took place, people sending money to London which they hoped to get back again later at a profit to themselves when exchange should have fallen. In two or three weeks therefore a marked divergence became observable between the market rate of exchange and the rate at which Reverse Councils were being sold. The market rate continued to fall ; but the rate of Reverse Councils, governed by the American cross-rate, remained high for a time.

The above-mentioned sagging of the market rate of exchange to a figure much below the rate for Reverse Councils, could not, however, have taken place merely as a result of the temporary stimulus to remittance from India to London just mentioned.

There was a fundamental cause tending to a weak exchange, namely, an adverse balance of trade which month by month was growing greater. It is instructive to study the monthly figures of the total value of imports and exports of merchandise given in the following table :—

Foreign Trade, 1919-1921.

—	Export.	Import.	Excess of Exports.	Excess of Imports.
	Rs. lakhs.	Rs. lakhs.	Rs. lakhs.	Rs. lakhs.
October 1919 ...	29,28	16,53	12,75	...
November ...	30,56	17,55	13,01	...
December ...	26,92	17,52	9,40	...
January 1920 ...	31,03	25,08	5,95	...
February ...	27,29	19,56	7,73	...
March ...	31,57	23,86	7,71	...
April ...	28,44	21,68	6,76	...
May ...	27,62	23,73	3,89	..
June ...	23,19	26,02	...	2,83
July ...	20,34	28,26	...	7,92
August ...	20,60	30,90	...	10,30
September ...	21,81	28,99	...	7,18
October ...	20,96	31,81	...	10,85
November ...	18,86	31,63	...	12,77
December ...	20,10	31,63	...	11,53
January 1921 ...	18,61	31,26	...	12,65
February ...	17,63	25,44	...	7,81
March ...	18,18	24,26	..	6,08
April ...	18,04	25,87	...	7,83
May ...	19,43	20,74	...	1,31
June ..	16,50	19,46	...	2,96
July ...	17,29	17,72	...	2,43
August ...	19,60	20,80	..	1,20
September ...	20,00	19,71	29	...
October ...	18,20	23,48	...	5,28
November ...	19,92	26,40	...	6,48
December ...	21,74	23,17	...	1,43

Average Foreign Trade for Three years—October 1910 to September 1913.

—	Exports.	Imports.	Excess of Exports.	Excess of Imports.
	Rs. lakhs.	Rs. lakhs.	Rs. lakhs.	Rs. lakhs.
October ...	1,819	1,393	426	...
November ...	1,829	1,366	463	...
December ...	1,640	1,124	516	...
January ...	2,072	1,436	636	...
February ...	2,202	1,133	1,069	...
March ...	2,242	1,260	982	...
April ...	2,109	1,315	794	...
May ...	2,079	1,243	836	...
June ...	1,849	1,066	783	...
July ...	1,988	1,192	796	...
August ...	1,682	1,337	345	...
September ...	1,816	1,379	467	...

The figures are compared with the average monthly value of exports and imports in the three complete years preceding the War. The purpose of this comparison is to show the extent of the normal excess of the value of exports over imports, which is characteristic of India's foreign trade. As is well-known, this excess of exports is counterbalanced in the balance of indebtedness by the commercial remittances of interest and profits, by the

Home Charges of Government, by payments for shipping freights and insurance, and by remittances of English residents in India and to Indians residing in London. It will be understood therefore that when in the first half of 1920 the value of the imports increased, whilst the exports remained stationary, so that the imports became actually greater in value than the exports, there, was, in the total balance of indebtedness, a considerable balance due outward.* The inevitable result of this was a heavy fall in exchange. Excepting when under special control, as in war time, exchange banks are bound to fix the rate of exchange in accordance with the conditions of supply and demand. When there is a heavy balance of indebtedness outward they must induce some remitters to cease making remittances by lowering the rate of exchange ; and they must also tempt some exporters to make sales at lower prices and get more business, and thus discount more bills, by the same action, namely lowering the rate of exchange. If they did not thus automatically reduce the demand for remittance from India, they would have great sums of money piling up in their

*In comparing the figures of the above tables it should be remembered that we are now on a much higher price level than before the war and that the remittances of all kinds which normally balance the excess of exports have expanded correspondingly since 1913. Consequently from January 1920 onwards the excess of exports was already below the present "normal."

Indian offices and be running short of cash for paying out their remittances in London.

On the other hand, when the economic conditions change and the trade balance becomes favourable to India, the exchange banks experience difficulty in the opposite way. The demand for discounting bills in India uses up their resources here too fast ; and the payment of those bills in London adds unduly to their cash balances there. When these latter conditions prevail, therefore, they have to purchase Council bills or gold for shipment.

But throughout the summer of 1920 the balance of indebtedness was strongly against India. The effect upon exchange was most marked in the months of June and October-November. On the 1st of June exchange stood at 2*s.* 1¼*d.* By the 11th it had fallen to 2*s.* 0*d* ; on the 15th it touched 1*s.* 10*d.*—then remained stationary for ten days : and then rapidly dropped to 1*s.* 8¼*d.* It remained at about this figure until the early part of July when a gradual recovery to 1*s.* 10*d.* took place ; and it fluctuated about this figure for the remainder of the summer.

This serious weakness of exchange seemed to be almost unaffected by the selling of Reverse Councils. The sales during the early months of the year were as follows :—

January	£5,394,000
February	£11,000,000
March	£9,988,000
April	£7,000,000

From the 29th April the amount of Reverse Councils offered weekly was reduced to £1-million ; and this amount continued to be offered weekly throughout the summer. Considerable speculation arose owing to the wide margin which prevailed between the official rate at which Reverse Councils were sold and the market rate of exchange. As allotments were made *pro rata* according to the amount of each application enormous total sums were applied for each week, as, for example, £122,000,000 on 15th June. The only limit was that no application might be made for more than the total amount offered, and many banks and firms regularly applied for the whole £1,000,000 each week. A few applicants were unable to take up their allotments. As it became necessary to check purely speculative applications, persons were required to deposit with their applications a sum equal to half of the sum applied for.

The adverse balance of trade was so heavy that the offer of £1-million weekly of Reverse Councils was quite insufficient to lift the market rate of exchange up to the rate at which Reverse Councils were being sold. When exchange fell to 1*s.* 8*d.* in June, it became obvious that there was no longer any ground for continuing the sale of Reverse Councils at a price based upon the recommendation of the Indian Exchange and Currency Committee. This extraordinarily severe adverse balance of trade may be said to be entirely unprecedented in the history of India. Perhaps the nearest approach

to it was during the famine years of the nineties. It shows the enormous difficulty of forecasting the course of economic events that this Committee of experts, which drew up its Report only six months previously, failed to anticipate any such severe reversal of the trade balance in the near future. They did, it is true, say that their recommendations might need reconsideration in the event of any heavy fall of world prices ;* but this heavy adverse balance came before any general fall of world prices. It was due mainly to the enormous growth of imports for making up the depleted stocks of all kinds which had run short during the war and for plant, machinery, material, etc., required for all kinds of industrial expansion, and to the fact that the demand for and prices of raw materials for export had fallen off early in the year owing to the American and European markets being glutted by the previous year's heavy purchases from India.

Events having proved that it was impossible to maintain the market rate of exchange anywhere near the theoretical outward gold point calculated on the basis of the American cross-rate as indicated above (page 261), the rate for Reverse Councils was based from 14th of June onwards on the permanent gold value of the rupee and fixed at 1*s.* 11$\frac{29}{32}$*d.*, this being the rate at which it was intended that Reverse Councils should ordinarily be sold when the new system is in full working order and sterling money again on a gold basis.

* Report, paragraph 51, page 23.

The weekly sales of Reverse Councils were suspended entirely at the end of September, and exchange immediately fell from the level of between 1*s.* 10*d.* and 1*s.* 10$\frac{3}{4}$*d.* at which it had been fluctuating to 1*s.* 7$\frac{1}{2}$*d.* and even to 1*s.* 5*d.* in December. This caused serious financial difficulties for many importers whose bills for large consignments, ordered when exchange stood at over 2*s.* had now to be paid at 1*s.* 5*d.* The further fall to 1*s.* 4*d.* early in 1921 accentuated these difficulties.

Gold Sales.

In the early summer of 1920, a heated agitation was raised in Bombay against the sale of Reverse Councils and the fortnightly sales of gold which were held by Government. It will be instructive to examine the reasons for Government undertaking the import of gold on its own account and selling it by public tender in India, and what was the economic effect of this, and its influence on the exchange rate. Owing to the restrictions placed on the export of gold by the belligerent countries the amount of gold imported into India during the war period was greatly reduced, so that the price of the sovereign rose from Rs. 15 to Rs. 19 and even to Rs. 21 for a short time. The profit on the importation of gold, if it had been possible for private traders, would have been enormous. However, so far back as June, 1917, an ordinance had been issued requiring all gold imported into India to be sold to Government at a price which was based on the exchange value of the rupee in sterling,

and took no account of the appreciation of gold in India. The acquisition rate was fixed from time to time at a point which made it just profitable to import gold into India after paying the cost of transportation. In 1919 the United States permitted the free export of gold ; and soon after a free market was permitted by the British Government in South African and Australian gold. The Government of India took advantage of this to make considerable purchases of gold in America, London and Australia, and by the end of November, 1919, about 2,485,000 fine ounces had been purchased. In the meantime Government had commenced, early in September, 1919, its series of fortnightly sales of gold in India. The following table shows the quantities offered for sale on each date for which tenders were accepted, and the average prices realised. The bazaar price of gold in Bombay is given for comparison :—

Sales of Gold.

Date of Sale.	Quantities for which tenders were accepted (in tolas).	Average price of accepted tenders.	Price of bar gold in Bombay bazaar.
1919.		Rs. As.	Rs. As.
3rd September ...	329,130	26 12	20 10
17th September ...	396,640	24 10	26 1
6th October ...	326,000	25 10	27 0
20th October ...	334,000	27 0	28 0
3rd November ...	325,000	27 15	28 5
17th November ...	518,500	27 11	28 2
8th December ...	1,000,650	26 4	27 10

Date of Sale.	Quantities for which tenders were accepted (in tolas).	Average price of accepted tenders.	Price of bar gold in Bombay bazaar.
1920.		Rs. As.	Rs. As.
5th January ...	763,300	26 8	27 3
19th January ...	800,000	26 15	27 5
5th February ...	756,450	25 10	25 6
19th February ...	960,590	21 9	23 4
3rd March ...	1,296,125	18 12	21 7
17th March ...	1,253,325	21 8	22 13
7th April	1,264,400	22 9	24 0
21st April ...	1,223,675	23 8	24 4
5th May	1,265,850	21 3	21 8
19th May	1,251,050	21 2	1 12
9th June	1,295,350	21 10	22 2
23rd June	1,260,250	21 0	21 8
7th July	1,348,500	21 2	21 6
21st July	1,295,500	22 1	22 5
4th August ...	1,315,950	22 6	22 7
19th August ...	1,266,500	23 10	23 7
1st September ...	1,274,200	22 11	23 1
14th September ...	1,252,500	23 13	23 8

It will be seen that the amount offered was greatly increased, until after the 3rd of March, 1920, it usually exceeded 1,250,000 tolas. The increase of available supplies was partly due to the action taken in September, 1919, of fixing the acquisition rate for gold brought into India so as to include the premium on gold over sterling as measured by the New York cross-rate. This re-established an effective inward gold point, and facilitated the import of gold to India as a means for the payment for the excess of exports alternative to the purchase of Council drafts.

It is instructive to observe the variation of the price realised for gold at successive sales as set out in the above table. The highest price was

realised not at the first sale, as might have been expected, but early in November. During the early months of 1920 there was a rapid fall of price. It is believed, however, that the very low figure, Rs. 18-12-4 per tola on the third of March was due to the breakdown of a ring of bullion merchants in Bombay who had hitherto by concerted action tendered at high rates, their object being apparently to save themselves from the heavy loss which would have resulted from a serious fall of the price of gold in the open market. Considerable profits were made by those who purchased gold in Bombay and arranged to send it up-country for retail sale amongst the mill-hands and richer cultivators, who eagerly seized the opportunity of buying gold now that it had become cheap.

It might have been thought that the continuance of these sales of gold, putting such a large quantity of gold into the market, would have led to a continuous decline of the price of gold in India. Undoubtedly it would have done so had the economic situation been normal. Remembering, however, that India was experiencing a heavy adverse balance of trade, we need not be surprised that the price of gold became intimately linked with the rate of sterling exchange. The rate of exchange fell in fact to the outward gold point which was determined by the price of gold in India, and similarly the minimum price of gold was largely determined by the rate of exchange. The two acted

and re-acted upon one another; because if exchange fell below a certain point corresponding with a certain prevailing price of gold it became cheaper to remit money from India to London and elsewhere by purchasing gold in Bombay and shipping it than by purchasing exchange in the usual market. According to the trade statistics nearly 213,000 ounces of gold were exported from India during the four months from July to October, 1920; and thereafter exports greatly increased.

Those who delight in calculations may easily satisfy themselves that it was profitable to export gold in June, 1920, rather than to purchase exchange. On the 29th of June the price of gold in Bombay as quoted in the newspapers was Rs. 22 per tola, whilst the price of gold in London was 104*s*. The Bombay quotation is for fine gold, and the tola weighs 180 grains. The British quotation is for the troy ounce of 480 grains eleven-twelfths fine, so that it contains 440 grains of fine gold. We may reckon the cost of shipping each ounce of gold and selling it in London at 10 annas. Hence the cost of an ounce troy of gold disposed of in London was :—

$$\text{Rs. } 22 \times \tfrac{440}{180} + 0{\cdot}62 = 54{\cdot}4.$$

The number of shillings which could be purchased by each rupee was, therefore, $104 \div 54{\cdot}4 = 1{\cdot}913$, which is very nearly 1*s*. 11*d*. At the same time the banks' selling rate for demand drafts, which are sent by post and are payable at sight in London was 1*s*. $8\frac{9}{16}d$.; and it is obvious that it was much

cheaper to ship gold. This explains both the rise of the price of gold in India and the rise of exchange which took place a few days later.

During the summer of 1920 we had, therefore, the peculiar phenomenon of gold being both imported and exported at the same time. The effect of the import of gold by Government and its sale in India was obviously the same as if Government were selling more Reverse Councils ; and tended slightly to raise the exchange rate. Government was, of course, using funds already accumulated in London to purchase the gold. If it had had to sell Councils in London so as to provide funds for purchasing the gold, this would have tended to depress exchange and to neutralize the tendency of selling gold in Bombay to raise exchange.

It might be inferred *a priori* from the above mentioned facts that there would be a close connection between the price of gold in sterling money and the price of gold in rupees : in other words that the appreciation of gold relatively to sterling money and to rupees would be the same. It is interesting to find that calculation shows that this was very nearly the case. It is usual to speak of the depreciation of sterling relatively to gold ; but as we cannot very well speak of the depreciation of rupees, since gold has not been worth Rs. 10 to the sovereign in modern times, it is better to calculate the " appreciation " in each case. On May the 31st, for example, the price of gold in London was 106*s.* 3*d.* per ounce, and the price of

English bar gold in Bombay was Rs. 22-12 per tola. The mint price of gold in England is 77.875*s.*; and the mint price of gold in India on the new basis of Rs. 10 equal to a sovereign is Rs. 15-14-10 or Rs. 15.927. From these we calculate that the appreciation of gold relatively to sterling on that date was 36.4 per cent, and of gold in India relatively to rupees was 42.8 per cent. At the middle of July the respective percentages were 36.8 per cent in England and 40.5 per cent in India ; and on August 26th, the respective percentages were 47.6 per cent in England and 44.5 per cent in India. The further appreciation of gold which had taken place by this time in England is accounted for by the rapid fall which had taken place in the London-New York exchange, and the further fall which was anticipated, the price being somewhat above the parity of that exchange.

It may seem surprising at first sight, after considering the high level of the rupee in sterling exchange which prevailed during the cold weather of 1919-20, to learn that by the summer of 1920 the rupee had become worth less in gold than it used to be in the old days before the War when the exchange remained fixed at 1*s.* 4*d.* Yet a simple calculation shows that this was the case. At the end of February, 1920, the market rate of exchange stood 2*s.* 7¼*d.* and the price of gold in London at 122*s.* 4*d.* ; consequently the rupee was worth in English gold 1*s.* 7¾*d.* Taking any date in the summer at random, we find that on August

26th the price of gold in London was 115*s.* and the rate of exchange 1*s.* 10¼*d.* which gives the gold value of the rupee in London as only 1*s.* 2⅜*d.* Later on in the year it became still less, and in 1921 fell below 1*s.*

Another point of interest is that with the rise of the price of silver in the summer of 1920 the Indian currency was again for practical purposes on the double standard. The price of bar silver in London on August 26th was 63¼*d.* per ounce. Calculation shows that at this price, allowing 3 per cent as the cost of shipment and insurance from Bombay to London, it would be profitable to export rupees when exchange was below 1*s.* 10⅞*d.* In fact, however, exchange stood on that date at 1*s.* 10¼*d.* Consequently it was undoubtedly profitable to export rupees as silver bullion ; and a certain amount was exported.

CURRENCY LEGISLATION

Whilst the economic conditions were dictating the fluctuations of exchange and the exports of specie above described, Government was taking the necessary legislative measures to bring into effect the new and permanent system of currency recommended by the Committee of 1919. On the 21st of June, 1920, the issue of an ordinance was notified which demonetised the sovereign and half-sovereign. From that date they ceased to be legal tender throughout the Indian Empire ; but the Government notified that for a period of 21 days sovereigns and half-sovereigns tendered at the office of any circle

of issue would be redeemed in currency notes at the rate of Rs. 15 for one sovereign. The total number of sovereigns redeemed during this short period amounted to about £2½-millions. It was further notified that sovereigns held in the Paper Currency Reserve would continue for the present to be valued at Rs. 15.

At the same time, as mentioned above, Government also announced the abandonment of the sale of Reverse Councils at the rate governed by the London-New York exchange and fixed the rate at 1*s.* 11 $\frac{13}{32}$*d.* for immediate telegraphic transfers as "being the rate which will ultimately hold when sterling once more returns to parity with gold."

A further important step taken on the 21st June was the removal of restrictions on the import of gold bullion and foreign gold coin ; but naturally the restrictions on the import of British gold coin had to be continued until the end of the period of redemption. The amount of sovereigns presented for encashment was large because the holders naturally anticipated a rapid fall of value when the period of redemption expired. Furthermore, it is believed that there was considerable illicit importation of sovereigns which were smuggled chiefly into Madras, Burma and Aden.

The period of redemption terminated on the 12th of August, and the price of sovereigns fell to about Rs. 14-12-0. However, as the price of gold rose a few weeks later in sympathy with the rise of the price of gold in England, due to the fall of the

American cross-rate and on account of the fall of sterling exchange, sovereigns, although passing merely as bullion, became again worth distinctly more than Rs. 15.

The next legal step taken towards establishing the new currency system was in the September session of the Imperial Legislative Council when the Hon'ble Mr. W. M. Hailey, Finance Member, brought in a Bill to alter the Indian Coinage Act of 1906 so as to make sovereigns and half-sovereigns legal tender in India for Rs. 10 and Rs. 5 respectively, and this was passed at a later meeting in the same month.

The changes which took place in the Paper Currency and its Reserve during 1920 are worthy of attention. The general economic position and the change of status of the currency all had their influence upon it, whilst the composition of the Reserve was affected by the legislative measures. During the later months of 1919 the Paper Currency circulation continued expanding. At the end of August of 1919 the gross circulation was about 170 crores ; by the middle of December it had risen to 181 crores ; at the close of the year it was very nearly 183 crores and by the middle of January had risen to over 188 crores. From that date there began a gradual contraction of the circulation, which by the end of February had fallen to 183 crores. By the end of March it had fallen to 174 crores ; and we notice for the first time in the return of this date a decrease in the amount of securities held in England.

These were valued at 82½ crores in the later months of 1919, and this figure remained until the later part of March. It will be remembered that the sales of Reverse Councils were commenced in January, 1920. They were met at first from the Treasury balances held by the Secretary of State ; but after these funds were considerably reduced, the sales of further Reverse Councils were met by realising the securities of the Paper Currency Reserve held in London. The currency notes tendered by the public in India for the purchase of Reverse Councils were made use of to reduce the circulation—that is, they were withdrawn from circulation and cancelled. Thus, the circulation and the Reserve in London were reduced by corresponding amounts at each sale of Reverse Councils from the middle of March onwards. This process of contracting the circulation in India was not viewed with favour by the commerical community ; because deflation of the currency is always a very uncomfortable process. The actual reduction of the paper rupees in circulation means that money becomes tight—in the money markets of Bombay and Calcutta it becomes difficult to get money on loan, and higher rates of interest have to be paid. Merchants cannot hold up their stocks of commodities for future sales ; and as stocks are thus brought into the market prices decline. This reduces the value of goods, such as cotton, jute, and piece-goods, which are pledged to bankers as security for loans, and the owners must find the necessary margin or have the goods sold. If the

circulation is reduced too fast, and prices are brought down too quickly, it is quite likely that many merchants may be placed in serious financial difficulties and some may go bankrupt. If they had heavy commitments to banks, this might even involve the banks in difficulty and create a commercial crisis. Hence, it is evident that great caution has to be exercised in contracting the circulation, however desirable an object that may be.

Throughout the summer the reduction of the circulation continued. At the end of May it was 167 crores ; at the end of June 164 crores and at the end of September 158 crores. At the same time the holdings of British securities in the Reserve had been reduced to 17 crores. Here we must note, however, that there was not a reduction of the circulation to correspond with the whole of this reduction of the holding of the British securities. Reverse Councils sold throughout the summer were paid in London from the sterling securities of the Reserve ; but not all the rupees paid for them in India were used to reduce the circulation, because this would have meant too great a contraction. By Act No. XXI of 1920 Government had taken power to hold the Reserve up to a total of 120 crores in securities, either in England or in India. This permitted the using of some of the receipts from the sales of Reverse Councils to increase the fiduciary portion of the Reserve held in India. At the beginning of 1920 the securities held in India were 17 crores ; by the end of September they had

increased to 47 crores. At the same time, the metallic portion of the Reserve, both gold and silver, was also increasing, having risen from 83 crores on January 1st to 94 crores on September 30th.

The important Paper Currency Act of 1920* made many amendments of the Paper Currency Act of 1910. The earlier sections make some administrative changes in the Currency Department ; but the principal provisions are with regard to the Reserve. These have been already dealt with in a previous chapter†; and it is only necessary here to remind the reader that the transitory provisions reducing the securities portion of the Paper Currency Reserve to 85 crores and the revaluation of the gold and sterling securities at Rs. 10 to the sovereign came into effect on 1st October, 1920. The permanent constitution of the Reserve cannot be given effect to at present.

A few words must be said as to the course of exchange during the last three months of the year. The sale of Reverse Councils was discontinued at the end of September, and Government announced that it was not their intention to resume such sales for the present. All support was withdrawn, therefore, from exchange, which was left to the tender mercies of supply and demand. Government withdrew altogether from the market : if they could not

*Act No. XLV.

†Chapter XII, Reserves and Balances, see pages 179-186.

sustain exchange by selling Reverse Councils they could at least avoid depressing it by selling Councils in London to provide funds for the Secretary of State's requirements, for he had still the whole of the Gold Standard Reserve of over £37,000,000 to draw upon if need be.

The effect of the cessation of sales of Reverse Councils was an immediate drop of exchange from about 1*s.* 10*d.* to nearly 1*s.* 8*d.* Thereafter there was a continuous downward tendency with only slight intervals of recovery. In November the average figure was about 1*s.* 7*d.*; and early in December exchange slumped badly to 1*s.* 4½*d.*, and varied between this figure and 1*s.* 5*d.* to the end of year. In January, 1921, exchange fell to about 1*s.* 4*d.* and a few weeks later to 1*s.* 3¼*d.*; and it remained fluctuating between 1*s.* 3*d.* and 1*s.* 4*d.* throughout the summer of 1921. In October there was a recovery to over 1*s.* 5*d.* which lasted some weeks; but, with the collapse of the German mark, exchange sank again below 1*s.* 4*d.*

Imports were particularly heavy in October to January, 1920-21, whilst the export trade showed no life, so that the balance of trade turned more strongly against India. It has to be noted, however, that exchange was in a very sensitive condition during the winter months of 1920-21, so that a comparatively small increase of payments due outwards or inwards produced respectively quite an appreciable fall or rise of the exchange rate. During all this period exchange was fluctuating

at, or a little above, the minimum determined by the combined effect of the price of gold, and alternatively of silver, in India and in England.

It is interesting in considering the theory of exchange to observe that during this period the exchange rate was subject to upward and downward limits, each determined by the relative price of gold in India and England (with silver as an alternative). The upper limit was determined by the cost of buying gold in England and importing and selling it in India, and exchange would have risen gradually to the level so determined (about 2*s.* 6*d.**) if the balance of trade had turned in favour of India. The lower limit was determined by the financial results of buying gold in India and exporting it; and this lower limit has been actually more or less in operation since the later months of 1920 because the balance of trade was against India. Theoretically the rate of exchange might have swung between wide limits of, say, 1*s.* 3*d.* and 2*s.* 6*d.* or even more. These limits were from time to time determined by the depreciation of sterling in England relatively to gold, and thus indirectly by the dollar-sterling exchange. As the latter comes back to normal so will the limits between which the rupee exchange can swing approach one another.

*This is the theoretical upper limit corresponding with the sovereign assumed to be worth Rs. 10 in India which is its minimum price. In practice it would take a very considerable influx of gold into India extending over many months to bring the market price down to Rs. 10, and raise exchange to 2*s.* 6*d.*

Lessons of 1920.

The principal lesson to be learnt from the exchange phenomena of 1920 is the very great influence which the balance of trade has upon the stability of the Indian system of currency and exchange. This lesson is one of the greatest importance when it is considered that India is peculiarly liable to sudden and violent oscillations of the balance of trade on account of the vagaries of the monsoon, and the somewhat speculative dealings of her import merchants, which are perhaps, to some extent, a result of the former cause. If there were in India a large quantity of gold in circulation, or if the Gold Standard Reserve held in London were twice its present size, any fall of exchange below parity would be an unlikely contingency. These conditions may be reached in the course of a few years or may be realised only after many years ; but the process of getting the Indian currency fairly settled on its new basis is full of difficulties. The economic situation will be best understood by expressing it as a depreciation of the rupee currency due to over-issue, in the sense that now that the troubles of war finance are over, there are more rupees in circulation than the country needs. This has raised prices in exactly the same way as the over-issue of paper money raises prices ; and the high price-level still prevailing in India is a considerable factor in the adverse balance of trade and weak exchange in 1921 and 1922.

This point of view also makes clear the present

relation of the rupee to gold. Viewed as a token coin, as the silver rupee now legally is, we may be said to be suffering from an over-issue of token coins. The rupee is now legally 11.3 grains of fine gold ; but is represented for circulation purposes both by silver rupees and paper money. That amount of gold is now worth a good deal more than one rupee ; but when the price of gold has been reduced from Rs. 28 per tola to Rs. 15-14-10 per tola, the sovereign will come into circulation at the legal rate of Rs. 10. The only possible means of bringing down the price of gold is to contract the rupee circulation relatively to the amount of work it has to do—that is the total volume of purchases and sales throughout India ; and a considerable contraction is necessary. The actual withdrawal and melting up of rupees by Government would effect the desired result if it were practicable. The alternative is an absolute cessation of the coinage of whole rupees until exchange is above 2*s.* and a gradual contraction of the paper currency circulation.

The situation is somewhat similar to that prevailing in the years which followed the closing of the mints in 1893. It was recognized then that the weakness of exchange was due to a redundancy of the circulation ; and the Government of India actually proposed to withdraw rupees, and to melt them up and sell them as silver bullion. The loss on such a transaction could be met either by additional taxation or by a loan. Such a drastic measure is probably unnecessary at the present

juncture. The stoppage of coinage after 1893 caused the situation to right itself in five years. The remedy in the present case is to coin no more rupees and to contract the paper currency as much as is conveniently possible. It was doubtless with this aim in view that Government ceased purchasing silver bullion in 1920 ; and the mints were kept occupied only with stocks of " Pittman " silver which had been purchased from the United States Government. The coining of this was completed in July, 1920, and since that month the coinage has been confined to silver 8-anna pieces and nickel subsidiary coins, and to recoining light rupees withdrawn from circulation.

The rapidity with which the price level may recede in India and exchange rise to the import gold point depending upon the American cross-rate will depend largely upon the seasons in India. If the level of world prices were to remain unchanged, good harvests of one year might possibly re-establish a favourable trade balance. Statistics prove, however, that a general fall of world prices has already begun ; and if the level of prices falls more slowly in India, and this is likely unless the rupee circulation is drastically contracted, the trade balance is likely to remain unfavourable and exchange weak. It is impossible to foretell the course of events ; but it may be said safely that if Government steadily and consistently follows the new policy which it adopted on the recommendation of the Committee on Exchange and Currency, it

cannot fail to realise its end in the course of a number of years. The new system of currency is sound in itself ; but the conditions early in 1920 were such as to make its immediate realization impossible. The Currency Committee did not anticipate an early fulfilment of their plans : they regarded it as their duty to lay down a line of policy which sooner or later, if steadfastly adhered to, would give India a stable and permanent system of currency.

CHAPTER XVI

THE RISE OF PRICES

Preceding chapters have been devoted to a description of the Indian currency system and the changes which it has undergone at various times, especially since the beginning of the Great War. It is the object of the present chapter to describe the changes that have taken place in the general level of prices ; and the next chapter will be devoted to explaining the cause of the great rise of prices in recent years. We shall find that it was mainly due to the effects of the war upon the money of other countries, which in their turn gradually affected India. It is important to realise, however, that prices had been rising almost continuously for many years before the war ; and also that the experience of India as regards prices has been similar to that of all other civilised countries. In all parts of the world there has been a great rise of prices in recent years. This can be proved by making comparative tables of the prices of a large number of commodities in former years.

Let us first see how far the prices of certain goods have risen during the war. In order to make a comparison, we shall start with the year 1913, as the war began in 1914. The quotations of prices

are collected from all parts of India by the Department of Statistics in the Government of India, and the following figures are all taken from the publications of that Department.* For the sake of illustration, let us take the figures for rice, wheat, jowar, salt and cotton cloth. Their prices are ascertained every fortnight ; and the Department of Statistics calculates the average of all the fortnightly figures of each commodity for each year. These yearly averages are as shown in the table on the next page.

* The figures are taken almost entirely from the publication entitled *Index Numbers of Indian Prices from 1861 to 1918*, and the supplements issued for 1919 and 1920.

TABLE OF PRICE CHANGES OF CERTAIN COMMODITIES, 1913—1920.

(*The figures in italics show the percentage change; 1913 = 100.*)

Year.	Rice (*a*) *per maund.*	Wheat (*b*) *per maund.*	Jowar (*c*) *per maund.*	Salt (*d*) *per maund.*	Cotton cloth (*e*) *per piece.*
	Rs. A. P.	Rs. A. P.	Rs. A. P.	Rs. A. P.	Rs. A. P.
1913 ...	5 3 0 *100*	3 11 6 *100*	3 0 0 *100*	0 8 7½ *100*	5 4 0 *100*
1914 ...	5 4 6 *102*	4 6 6 *119*	3 4 9 *110*	0 9 6 *111*	4 12 0 *90*
1915 ...	6 0 0 *116*	5 6 0 *144*	3 4 0 *108*	1 4 0 *233*	4 2 0 *79*
1916 ...	6 4 0 *121*	4 13 0 *130*	2 12 9 *93*	1 9 1½ *292*	5 0 0 *95*
1917 ...	5 1 0 *97*	4 12 6 *129*	3 1 3 *103*	2 4 0 *420*	7 2 0 *136*
1918 ...	4 2 0 *80*	5 9 6 *151*	5 2 3 *170*	2 6 9 *451*	12 4 0 *233*
1919 ...	6 15 6 *134*	8 3 6 *221*	6 15 4 *232*	1 12 3 *328*	12 12 0 *243*
1920 ...	8 6 0 *161*	7 0 0 *188*	5 8 0 *183*	1 8 2 *280*	14 2 0 *269*

(*a*) Average of the average annual wholesale prices of Moonghly and Ballam at Calcutta.
(*b*) Average annual wholesale price of Doodhia (wheat) or Club No. 2 at Calcutta.
(*c*) Annual average of the retail prices of Jowar at 15 selected stations.
(*d*) Annual average wholesale price of Liverpool salt (excluding duty) at Calcutta.
(*e*) Annual average wholesale price of T. cloth (44 inches by 24 yards) at Bombay.

Below the price of each commodity is given in italics a percentage figure showing the proportion of rise or fall. It will be seen that the prices in 1913 are represented by 100 in each case and the percentage figure in any later year shows the exact proportion of the rise or fall of prices in that year as compared with 1913. These percentage figures are very useful, because they enable us to make an average of the percentage figures for any one year, showing the average rise or fall of prices of all the commodities taken together. For example, if we take the percentage figures for 1917 for the above five commodities and add them up, we find that the total comes to 885. If we divide this by 5, because there are five commodities, we get 175 as the average percentage increase. This figure is called an *index number,* and it represents the average rise of prices of those five commodities, the average for 1913 being taken as 100.

By taking only five commodities we cannot get an index number which is reliable as an indication of the general change of prices, because individual commodities may be greatly affected by special causes ; and amongst so small a number one such exception may have a great effect. Averages of percentages calculated in this manner are made, therefore, from the series of yearly prices of a much larger number of commodities, usually 40 to 50 or more. Such index numbers have been compiled both for wholesale prices and retail prices.

Prices are generally studied from two points of

view—that is to say, with two quite different objects. On the one hand index numbers are calculated which are intended to show the average rise of the prices of *all* commodities, the assumption being that the 40 or 50 commodities whose prices are actually averaged are sufficient in number to represent fairly the changes which are taking place in the prices of all commodities. Of course, the prices of individual commodities are changed by special causes affecting that commodity alone ; but in taking an average of the prices of 30 commodities the results of such special causes are averaged out. The prices of some commodities rise more or less than the average—one or two may fall while the rest are rising. However, if the number of commodities be large enough the changes due to causes specially affecting particular commodities are almost completely eliminated in the general average. This elimination is more complete with a total of 40 commodities than with 30, and still better with 50 or 60. When such a large number of commodities is used we may be pretty sure that the index number tells us fairly accurately what we are seeking, namely—*the change in the purchasing power of money.* Thus, if the index number of prices has increased from 100 to 125, the purchasing power of money has fallen from 100 to 80 ; and if the index number has fallen from 100 to 75, the purchasing power of money has increased from 100 to 133.

On the other hand, index numbers are also used

for another very important purpose—for *measuring changes in the cost of living.* In this case it is not sufficient only to learn what has been the change of the purchasing power of money, for we do not buy all commodities in equal quantities. The cost of living of ordinary people is affected much more by a change of the prices of the staple food-grains and of cotton cloth, than of other commodities. A system is adopted, therefore, by which prices are "weighted" according to their importance in people's expenditure before an index number is calculated. In order to be quite precise in our result it would be necessary to calculate a separate index number for each class of persons—rich and poor, vegetarian or non-vegetarian, and a separate index number for each part of the country according to whether the principal food-grain is rice, or wheat, or *bajra* and *jowar* (or *ragi*)* The calculation of a number of different index numbers in this manner for different regions and different classes of people has not been attempted yet. From a study of "family budgets"—that is family expenditure—of the poorer classes in various parts of the country a rough weighting has been chosen which is taken to be roughly representative of those classes in all parts. The error involved should be borne in mind, however; for obviously if rice is cheap whilst wheat is dear, the

* Various millets—*bajra* and *jowar* used in North India and *ragi* in the South.

people of Bengal will be better off than the index number shows, and the people of the Punjab worse off.

The Department of Statistics in India hopes to undertake the calculation of an index number to represent the cost of living of the industrial classes based upon the prices of 40 commodities collected in about 40 towns. In a few years very valuable information as to the changes in the cost of living will be obtained and collated in a general index number and local index numbers. In the meantime there is no reliable guide as to the extent of the recent changes of the cost of living.*

The rise of prices which took place in India during the war and subsequently is illustrated by the following series of index numbers prepared by the Department of Statistics for (1) the wholesale prices of 39 commodities ; (2) retail prices of 7 food-grains :—

Year.	Wholesale prices of 39 commodities.	Retail prices of 7 food grains.
1913 ...	100	100
1914 ...	103	111
1915 ...	106	109
1916 ...	129	100
1917 ...	137	101
1918 ...	157	135
1919 ...	193	200
1920 ...	196	178

* Since the above was written the Labor Department of the Bombay Government has started publishing monthly index numbers of the cost of living in Bombay which are of great interest and importance. (See *Labour Gazette,* Bombay Labour Office).

The above figures show clearly that there has been a very considerable rise in the general level of prices ; and that the prices of food-grains, which rose sharply in 1914, fell back again in 1916 and 1917 to the level of prices in 1913, whilst the prices of commodities in general continued rising. This was due to the exceptionally good harvests of the years 1916 and 1917. In 1918 and 1919 the bad weather conditions are reflected in very high prices, which brought the food-grain prices very nearly up to the general level of prices in India.

It is necessary to warn the reader against assuming that the above quoted index number is an actual measure of the extent of the general rise of prices ; that is to say, of the depreciation of the purchasing power of money. Without going into technical discussions it may be said that this index number is defective in several ways: (1) The number of commodities of which prices are incorporated is too small ; and amongst the 39 which are used is too large a proportion of foodstuffs (25 per cent). (2) Practically all the prices, except those of food-grains, are chosen from quotations in the markets of the great seaport towns of commodities imported or exported ; and as these naturally tend to be equal to prices in the world's markets, differing only on account of freight rates and exchange fluctuations, the index number tends to follow the general level of world prices rather more closely than the real level of prices throughout India does. Probably this index number rose

faster during the war than the true level of prices, and fell in advance of inland prices after 1920.

For the purpose of roughly illustrating the rise of the cost of living, and with a view to finding out the approximate increase of the cost of living to persons of the wage-earning classes, I have had some calculations made from the prices of the above mentioned 39 commodities, which are the only easily accessible, authentic and up-to-date price records which have been published. The following index number of the cost of living applies to persons living in towns and earning not more than about Rs. 40 per mensem. The weighting has been carried out on the assumption that out of the total expenditure a little more than half (55 per cent.) is spent on various foods, one-tenth on cotton-cloth, and the remainder on house rent and various articles, such as salt, brass utensils, etc.

Rise of the cost of living, 1913 to 1919.

Year.	Mainly rice eaters.	Mainly wheat eaters.	Mainly millet eaters.
1913 ...	100	100	100
1914 ...	103	106	102
1915 ...	115	121	106
1916 ...	128	130	123
1917 ...	138	141	127
1918 ...	144	164	146
1919 ...	173	192	172

Changes of the general level of prices took place long before the Great War and have in fact been taking place for centuries past. It is not possible to go far into this interesting subject here ; but it is desirable for the public to be acquainted with the outstanding facts of price changes during the past fifty years. Index numbers of prices in India extending back to 1861 have been prepared and published ; and index numbers of prices in England, America and other countries are available for a much longer period. It is only possible here to print the index numbers of prices in India, England and America back to 1861, and at intervals of five years prior to 1913. The figure for 1873 is also given as prices in Europe reached their maximum in that year before the long decline which lasted twenty years. In the United States, owing to the Civil War, the maximum of prices occurred earlier ; whilst in India the maximum was in 1866 (115). From about 1885 in India and from 1896 onward in England and America, the level of prices rose considerably with occasional fluctuations until 1914, when prices started rising very much faster owing to the war. It will be observed by inspecting the diagram on the opposite page that during the war prices rose more rapidly in England than in India or in America.

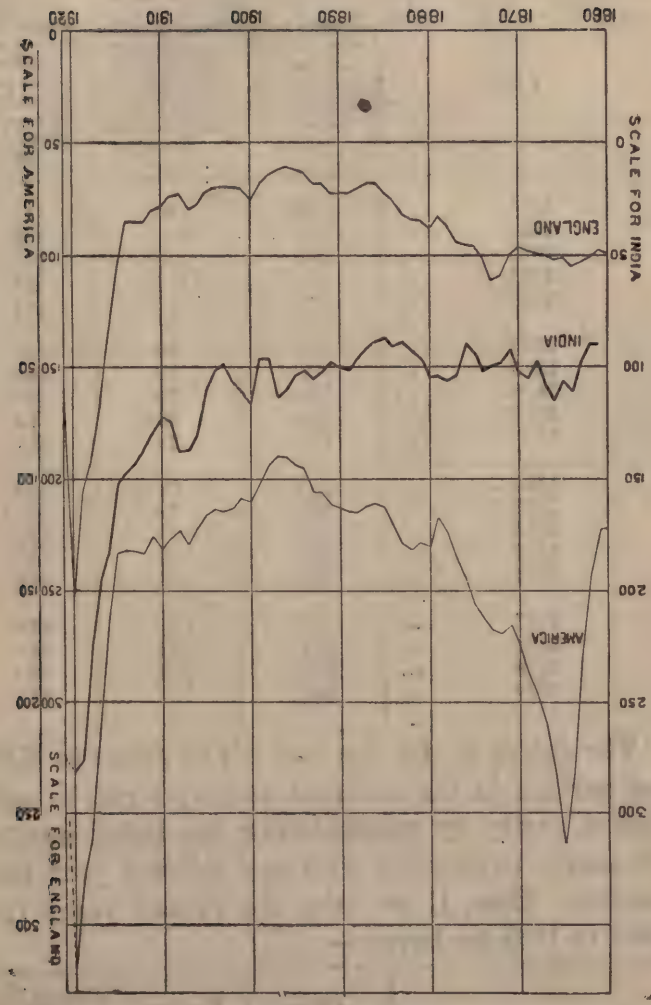

DIAGRAM OF INDEX NUMBERS OF PRICES

The index numbers for India are those published by the Department of Statistics, Calcutta. For England those of Sauerbeck, continued by *The Statist*. The American index numbers are compiled from Falkner's series (not reduced to gold) and that of the U. S. Bureau of Labour Statistics.

Year.	General index number of 39 articles (Department of Statistics) for India (1873 = 100).	General index number of 45 commodities (Saurbeck's) for England (1867-77 = 100).	General index number of the wholesale prices in the United States of America (1890-99 = 100).
1861 ...	90	98	111
1865 ...	107	101	239
1870 ...	102	96	157
1873 ...	100	111	155
1875 ...	94	96	141
1880 ...	104	88	118
1885 ...	87	72	103
1890 ...	100	72	113
1895 ...	104	62	94
1900 ...	116	75	110
1905 ...	110	72	116
1910 ...	122	78	132
1913 ...	143	85	132
1915 ...	152	108	131
1916 ...	184	136	163
1917 ...	196	175	232
1918 ...	225	192	258
1919 ...	276	206	280
1920 ...	281	251	321

The extent of the rise and fall of prices in different periods in the different countries can be ascertained easily by recalculating the index numbers by simple proportion with any selected year taken as 100. Thus, if we take the twenty years from 1865 to 1885 we have :—

	India.	England.	United States of America.
1865 ...	100	100	100
1885 ...	81	71	43

Taking the period of rising prices before the war from 1895 we have :—

	India.	England.	United States of America.
1895 ...	100	100	100
1913 ...	138	137	141

During the war period the rise of prices was :—

	India.	England.	United States of America.
1913 ...	100	100	100
1919 ...	193	242	214

CHAPTER XVII

CAUSES OF THE RECENT RISE OF PRICES

We have seen in the last chapter how great was the general rise of prices in India during the six years which followed the outbreak of the Great War. At first the prices of imported articles rose more than the prices of exported articles, because prices in the countries at war rose much faster than in India. Yet the prices of all articles began to rise to much higher levels in India after three or four years of war. The explanation of this will be given in the present chapter. It is necessary to bear in mind, however, that, as was explained in the last chapter, the general level of prices had been rising in India for nearly twenty years before the war. We saw further that the big changes which have taken place in the general level of prices in India have always followed pretty closely the change in the general level of prices in the other principal countries of the world.

During the nineteenth century, the building of great steamships in England enormously increased the trade which was carried on by sea between the different countries of the world ; and in this deve-

lopment India shared. For many kinds of goods, such as wheat, cotton, jute, hides, tea, lac, etc., the market had become worldwide. Consequently, the prices of these commodities in every country came to depend upon the supply of and demand for them in all countries of the world combined. India contributed part of the demand and a considerable part of the supply in the case of some commodities ; yet the prices prevailing in India were those established in the world market as a whole, and frequently depended upon the success or failure of crops in America or Russia, and on other causes wholly unconnected with India. The dependence of the prices in India of commodities which are largely exported from, or imported into, India, on prices in the world's markets, is easy to understand. This, however, does not wholly account for the change in the general level of prices, which has been going on in all the principal countries of the world, and also in India at the same time.

The explanation of the great rise of prices which has taken place throughout the world since 1897, and much more rapidly since 1914 must be looked for amongst those causes which would be capable of affecting the prices of *all articles at the same time in the same way.* There are obviously many separate causes which affect the price of any particular commodity, such as a shortage of supply, increased cost of production, or a sudden increase of demand. A general rise of the prices of nearly all commodities in a country at the same time can, how-

ever, only be due to some kind of change in regard to money. Price is simply a statement of the quantity of money given in exchange for a unit of the goods ; and it is only causes which have relation to money, or are in some way dependent upon money, which can affect all prices. We may proceed to enquire then what changes in the money or currency in use in a country have an effect upon prices.

The general level of prices in any country depends principally upon two causes : (1) the quantity of money, and substitutes for money, in use in the country; (2) the rapidity of circulation of that money. We shall see how these causes act. Let us suppose, for example, that in all India the total amount of money of all kinds in use is 200 crores of rupees. Let us suppose further that for some reason the total amount of money in the country suddenly increases to 400 crores of rupees. Let us again suppose that this increase takes place in such a way that everybody has twice as much money as he had before. He would then be able, if necessary, to pay twice the price which he formerly paid for everything which he purchased, and yet he would be just as well off as before in actual goods. In order that everybody may receive twice as much money as he received before, the prices of all kinds of goods will be doubled, and the rates of salaries and wages will be doubled. In other words, money would be worth just half as much as it was before.

The second cause, the rapidity of circulation of money, has its effect upon prices in a different

way. Let us again suppose that the total amount of money in the country is 200 crores of rupees. Under the existing conditions of trade, and the prevailing habits and customs in regard to the use of money, this amount of money does a certain amount of work—that is to say, a certain number of sales and purchases are made with it per annum, adding up to a grand total of so many hundreds of crores of rupees. Let us suppose that people change their habits, or that the development of the country with roads and railways has made communications more rapid. In this and other ways, the same stock of money (200 crores) may actually be the medium of making purchases to a much larger total sum. The money will tend to flow through the usual channels of trade so much the faster. It will go, for example, from a Government treasury to pay the salaries of government employees, through them to shopkeepers, from shopkeepers to banks. From the banks it may be paid out again to railway companies and cotton mills to pay their employees, and through shopkeepers and wholesale merchants it comes back again to the banks, but a part goes to the cultivators and through them to the zemindars and back into Government treasuries as land revenue. This circulation is always going on; but if the circulation becomes more rapid, that is, if the total stock of money is "turned over" more often in the year, prices will rise in the same proportion as the money is more frequently used.

It is important to notice the difference between

these two causes, however. In the first case, there is an actual change in the quantity of money in the country ; but in the second case, the change is in the habits and customs of the people, which leads to the more rapid circulation of money. The former case is probably the one which is responsible for every great and rapid change in the level of prices ; for any change in the customs and business methods of the people is likely to take place slowly, so that its effect upon the level of prices would only become apparent after a long series of years.

The next question to be considered is how the quantity of money in circulation comes to be increased. This may happen in various ways, which we shall group under two headings : (1) forced increase of the circulation ; (2) automatic increase. I have put the forced increase of circulation first merely because it is the simpler to understand : the more important in the case of India is the automatic increase.

The forced increase of circulation will be easily understood if we consider first a rather fanciful example. Let us suppose, for a moment, that it were possible for Government out of its balances and moneys raised on loan to buy at an average price of Rs. 53 per 100 tolas enough silver to coin 100 crores of rupees. At this price Government, after paying the cost of coinage, would make about 8 annas profit on every rupee. It would make altogether about 50 crores of rupees profits ; and if Government wanted to make any big expenditure either for

carrying on war, or for making great new railways and irrigation canals, it might conceivably adopt this method. All this extra expenditure would be made out of the stock of rupees which was thus so profitably coined. These being legal tender, people would be forced to accept them ; but the total number of rupees in circulation would be rapidly increased, and this would lead to a general rise of prices. A much simpler method than coining so many rupees is to issue a huge quantity of paper money and to force people to accept it by law. This was done in different countries at various times long before the war ; it was resorted to greatly during the war, and is being done most particularly by the Government of Russia at the present time. If Government wished to incur expenditure far greater than its revenue from taxation, it could adopt this method of meeting it, forcing people to accept currency notes in exchange for their goods, and for their labour. This again would be a forced increase of the circulation and of course prices would rise. In proportion as prices rise so is the currency " depreciated ", that is to say, reduced in purchasing power. It will be realised that a forced issue of token currency or paper money has the effect of transferring so much " spending power " from the people at large to Government. It is like a forced loan without interest, levied upon the whole population.

The extent to which this method of financing their heavy expenditure was resorted to by various Governments during the War is not sufficiently realised.

Every country at war issued vast quantities of paper money, either through the State banks, or directly by Government—in most cases, the latter. According to some statistics collected in America,* the paper currency in existence in fifteen of the principal countries of the world at the beginning of the war amounted to the equivalent of 1,600 crores of rupees, calculating the money of each country according to the par of exchange. At the end of the War these same countries had in circulation 8,800 crores of rupees worth of paper money, calculated at its nominal value. This means that the paper currencies of these countries were increased to 5½ times what they were before the war. It is not a matter for surprise therefore that prices have risen enormously in European countries. The above figure (Rs. 8,800 crores) gives the circulation at the end of 1918, soon after the cessation of hostilities. Almost every European Government was compelled to go on issuing more paper money during 1919, and many in 1920, so that the circulation at the present time must be considerably greater. It may be added that the above-mentioned figures of the paper currency in existence at the end of the war do not include the rouble notes issued by the Bolshevik Government. During the first eighteen months of its existence that Government is said to have issued paper money equivalent in nominal value to the enormous sum of 16,000 crores of rupees, or about

*_Bankers' Magazine_ (New York), Vol. XCVIII (1919), page 670.

32 times the entire circulation of metallic and paper money in India.

When the quantity of money in use in any country increases rapidly from any cause to a greater extent than the increased production of commodities, the invariable result is a rise of prices. The currency is then said to be *inflated*. As has been pointed out above, such inflation of the currency may come about in various ways, which may be grouped under the headings of : (1) a forced increase of the circulation ; and (2) an automatic increase of the circulation. The former method has been briefly considered ; and we shall now proceed to consider the various ways in which an automatic inflation of the currency and of credit may come about.

Inflation of Credit and Currency

In saying that the increase is automatic, we mean it happens without anybody intending to increase the total amount of money. It results indirectly from certain economic conditions which are bound to have that result, because they either cause an inflow of money into the country, or create substitutes for money within the country which increase the effective volume of the circulating medium.

The term " substitutes for money " is one which must be carefully explained. It may be taken to include all those documents and ways of representing money which are used by merchants and bankers. Whenever a person of good credit promises to pay money at some future date, that promise is capable of acting in its effect upon prices as if it

were money. The commonest form of such promises is the *hundi*. Bankers create a kind of credit money which can be paid by one person to another by the use of cheques. Money on deposit with a banker which is subject to withdrawal on demand by cheque, may be drawn in the shape of coin or currency notes ; or it may be transferred by cheque either to some other person's account in the same bank, or to the credit of somebody in another bank. These transfers of credit greatly exceed in value the actual withdrawal of coin. This credit money held with bankers is therefore a substitute for money.

All substitutes for money act upon prices exactly in the same way as money itself. We have seen in previous chapters that a currency note represents so much gold or silver, and may be exchanged for it. In the same way a *hundi* represents so much money, if the credit of the drawer, or drawee, is good. If a bank is believed to be sound, the amount of credit money which the banker keeps at the disposal of his customers also represents so much standard money because the deposit may at any time be drawn out in the shape of standard money. In a gold standard country, all these substitutes for money actually represent gold ; and an increase in the quantity of the substitutes for money has the same effect upon prices as an increase of the quantity of standard money or token money in circulation would have.

We may now consider in what ways an automatic increase of the circulation may come about. There

are two ways in which this happens : (1) by an extension of credit in the country itself ; (2) as a result of a favourable balance of trade caused by a rise of prices in other countries.

An extension of credit may come about within a country in several different ways. Let us take the simplest case first. Suppose that in a certain town the custom is that everybody must pay cash for everything at the time of purchase. Suppose now that the custom is suddenly changed, and that all the merchants and shopkeepers give three months credit to some people and six months credit to other people. The public can now buy large quantities of things which they do not have to pay for until several months later. Their buying power is greatly extended, and prices would suddenly rise and continue rising for two or three months until people had exhausted the additional buying power which the extension of credit gave them. Notice that, so long as this long credit continues to be granted, the effect is the same as if there were more money in circulation, for *A* who has bought goods from *B* may sell them to *C* for cash or prompt payment before he has paid *B*.

There is another way in which credit is extended, and that is through the agency of banks and the system of payment by cheques. In a sense the banker makes credit money. He gives a loan to *A* which enables *A* to purchase many goods which he pays for by means of cheques drawn upon his account in his bank. Now the persons from whom he buys the

goods pay his cheques into their own banks, where the amounts of money they represent are added in the banks' books to the deposits held on behalf of those customers. But each of these banks has many customers, and to many of them loans are granted ; and the persons who thus get loans from their banks pay the money so received into other banks. Consequently, every bank in which the public has confidence receives deposits which enable it to continue making new loans. Thus both the loans and the deposits go on increasing at the same time. The increase of deposits does not represent any increase in the actual money of the country ; that is to say, any increase either of the coins or the currency notes in circulation. It is purely " bank money," or credit money, which is utilised to make payments by means of cheques, bills of exchange (hundis), and other paper documents.

It is true that every customer has the right to demand from the bank the payment of his deposit in actual cash, that is to say, legal tender money, either coins or notes. This is one of the two considerations which prevent bankers going on manufacturing credit money without limit, in which case they could enormously enrich themselves at the expense of the community, raising prices throughout the country. Since, however, they are liable to pay for the deposits in gold and silver, they must keep an adequate reserve of legal tender money actually in the vaults of the bank to meet all probable demands upon them. The banker always

keeps account of the quantity of gold and silver, or currency notes, which he has actually in his possession, and if this becomes reduced to less than one-fourth or one-fifth of the deposits repayable on demand, he makes great difficulties about granting new loans, and tries to call in the old ones, so as to have more cash at his disposal.

The second consideration which prevents the banks making unlimited loans, and thereby receiving unlimited deposits, is the question of the security which the borrowers can give. The banker lends only small amounts on personal security, and he requires some tangible property as security for most of his loans. Certain kinds of goods and property are accepted by bankers as security, mainly those kinds which can be easily sold, if necessary. When such kinds of property increase in quantity throughout the whole country, then an extension of credit is practicable without the bankers incurring any more risk, and they eagerly seize the opportunity ; and so the total amount of credit money in existence increases. This happens when harvests are exceptionally good. The bankers will lend upon the cotton, the wheat, and all the other crops, and these crops are thus turned into money as soon as they come off the fields ; or in America even before the harvest is reaped.

Bankers are always pleased to lend upon Government securities ; and the more loans the Government issues, the more can banks manufacture credit money. This is what happened on such a

large scale in England and other countries during the war. The British Government issued hundreds of crores of rupees worth of war loan stock. Many people who bought this loan stock took it to their bankers and borrowed nine-tenths of the value of the loan stock from their banks, and with the money so obtained subscribed for more war loan stock, which again they took to the bankers and borrowed more money on that security. It is obvious that in this way the quantity of bank money in existence must have increased enormously; and in fact the deposits in English banks (excluding the Bank of England*) did increase during the war from the equivalent of 1,070 crores of rupees to 2,300 crores of rupees (converting at 2*s.* in each case).† This was the principal cause of the great rise of prices in England.

It was stated above that the second way in which the circulation may be automatically increased is by a favourable balance of trade. This either brings great quantities of money into the country, in the form of actual gold and silver, or leads to the issue of currency notes by Government against an increase of the invested portion of the reserve which is held in a foreign country. No doubt there was some extension of credit in India during the war, and some creation of bank money ; but it was very small compared with the extension of credit which occurred in those countries of Europe which were actively

*The deposits in which belong mainly to other banks.

†The increase was from £1,070,000,000 in 1914 to about £2,300,000,000 on 31st December, 1919. See *Bankers' Magazine* (London), 1920, page 468.

engaged in the war. The result of great rises of prices in England, France, and other allied countries, was that they exported fewer goods to India, and imported enormous quantities of raw material and food from India, for which they were ready to pay very high prices. There being a large balance of payments due to India, the Secretary of State sold Council bills as fast as possible in London and accumulated there many millions of pounds English money. The Government of India issued currency notes in India to pay these bills, and the money in London was invested. Those investments were counted as part of the reserve for the issue of the currency notes. A large part of the money obtained by the sale of Council bills was also used to purchase silver and bring it to India for coinage, so that the circulation of rupees in India enormously increased. The high prices abroad and the needs of the Indian Army led to all producers in India—the cultivators, the factory workers, and unskilled coolies—being able to obtain much higher remuneration for their work than ever before. In this way the large amounts of money which came into India through the favourable balance of payments became distributed gradually throughout the population ; although first of all the merchants, mill-owners, and other employers had the opportunity of making great profits before the people at large awoke to the fact that they could obtain higher prices for their labour. In one way or another, the increased amount of money which had come into India became

distributed throughout the population, and as it did so, so did prices in general rise.

The foregoing is a nearly complete explanation of why the general level of prices in India rose so greatly during the war. It will be observed that the ideas of most people on this subject are entirely wrong. They blame the merchants and the financiers for withholding goods from the public in order to increase prices, and many people think that Government is in some way responsible for prices rising so much ; but these ideas are entirely wrong. A few cases occurred no doubt where merchants anticipated a future shortage of goods and held up stocks for a few months, so that prices rose at once instead of at a later date. A notorious example was the corner in salt which greatly raised its price in 1918. This was due to the fact that imports of salt by sea had been greatly reduced and stocks were already small in certain places. The very great increase of the price of cotton cloth too was in the first instance due to the special causes connected with the war, particularly the shortage of production in England, the very great increase of the cost of the cloth made there, and the increase of freight rates to India. But these special causes only anticipated a little the rise of prices which was taking place for all commodities and must have taken place for these particular commodities a year or so later.

The idea that Government was responsible for raising prices is obviously false ; for the rise of prices in India was due to the great rise of prices in

other countries, caused by the war, which led to such vast quantities of money being sent to India to purchase our goods. The Government could only have stopped this by cutting off our exports more than it actually did, which would have greatly handicapped England and her Allies in the prosecution of the war, and might conceivably have led to defeat instead of victory.

Many people have been puzzled as to why prices should have continued rising after the end of the war. They could understand that prices would necessarily rise whilst fighting was actually in progress, but thought that immediately it was over, prices would begin to go down again. There are at least three reasons why this did not occur. In the first place a very great shortage of commodities of all kinds had resulted from the war. Consequently, throughout 1919 there was a very active demand for many commodities which India supplies ; secondly, the Governments of Europe and America had enormous armies in the field, and it took more than twelve months to carry out demobilization. All this involved continuous expenditure, and the various Governments were still issuing loans and still putting more paper money into circulation in order to meet these charges. The third reason is that, owing to this further inflation of the currency, prices in other countries of the world still continued rising ; and the rise of prices in India, which had always lagged behind, had still to overtake prices outside.

During 1919 Government took the only step which

could prevent a further rise of prices owing to the same causes, namely, raising the rate of exchange, which made it less profitable for foreigners to buy goods from India and very profitable for us to buy goods from abroad. Thus the great stream of money coming into India was checked ; and, as described in an earlier chapter, the balance of trade turned strongly against India in 1920 and continued so in 1921 and 1922.

Prices began to fall in the great commercial countries of the world in the summer of 1920 ; and as usual the movement extended to India a few months later. A general fall of prices in foreign countries increases the import trade, as it becomes more profitable to buy abroad, and decreases the export trade ; so that the balance of indebtedness turns against the country, and money leaves the country. The adverse balance of trade in 1920 and 1921 led to the export of much gold and silver, and the sale of reverse Councils led to a contraction of the paper currency circulation. So soon as expenditure on behalf of the British Government was stopped, as it was late in 1920, the export of money and the contraction of the circulation made a fall of prices inevitable for the same reasons that an inflow of money and expansion of circulation cause a rise of prices. There seems to be no doubt that we are now entering on a long period of declining prices throughout the world ; and this must automatically cause a continuous fall of prices in India, which will be a welcome relief to the population.

During 1921, however, the fall of prices in India was so slight as to be hardly noticeable. The continuance of high prices in this country has been in marked contrast to the extensive fall of prices in England, America and other countries during 1920 and 1921.

During the first-half of 1922 prices fell only slightly in India, and exchange weakened still further and fell to 1*s.* 3*d.* This was due largely to the fact that deflation, which commenced in 1920, was not proceeded with, mainly on account of the continued excess of Government expenditure over revenue which led to temporary borrowing on a larger scale by the issue of Treasury Bills. Deflation means contraction of the circulation, and is carried out by withdrawing notes and cancelling them instead of paying them out again or into a bank. The cancellation of notes involves reducing the funds available to banks and the money-market, and to do this too fast might cause a commercial crisis.

CHAPTER XVIII

SOME POPULAR FALLACIES

There is probably no subject which has been studied as a science in which popular opinion so frequently strays from the truth as in economics. Nobody now ventures seriously to assert that the sun moves round the earth, or that forecasts of the weather should be made from the phases of the moon and planets. The popular mind is very apt to jump to conclusions and to reason from the particular case to the general. It omits to take account of modifying factors—and does not distinguish between the immediate and ultimate effects of a cause. Even business men, who are thoroughly acquainted with the facts of commerce, money, and exchange, frequently form wrong opinions as to economic causes and effects because they have had no training in economic analysis and so have not been accustomed to search out and allow for all the various factors which enter into the causation of a particular phenomenon.

On the other hand, many popular fallacies arise simply because people fail to take the right point of view. A good example of this is the accusation sometimes made against the Government that it carries out its currency and exchange operations

more with a view to making a profit than for the benefit of the country. Now, it cannot be denied that Government does generally make a profit out of the coinage of rupees and subsidiary coins of silver and nickel, and that it sometimes makes a profit out of exchange operations, just as it sometimes makes losses. Furthermore, the issue of paper currency is a source of profit to Government in normal times; for the interest upon the securities in the Paper Currency Reserve, amounting to about Rs. 2 crores per annum, is no inconsiderable addition to the revenues of the country.

The fallacy is obvious immediately it is considered what the words mean. Those who blame the Government for making a profit seem to imply that Government is something apart from the people in the country—that it is a gigantic trading corporation, making profits out of its functions of Government and sending those profits abroad. This idea might have had some shadow of truth in the old days of the East India Company, though that Company usually made only a very small profit out of its currency and exchange operations. The Government of India, as it now exists, and has existed for 70 years, has no revenues apart from the revenues of the country as a whole. It has no private pocket into which to put profits arising from currency and exchange. If these operations do produce a profit, as they frequently and rightly may, such profit forms part of the revenues of the Indian Empire. It is a source of income to Government, just as are

profits in the working of railways and irrigation canals. If there were not some profits from the currency and exchange, additional taxation would be necessary to make up for revenue thus lost.

It will be seen therefore that the question of profits on these financial operations of Government must be judged simply on the same basis as the question of profits from the commercial services, and such questions as whether or not a certain tax should be increased. That basis is whether certain particular classes of persons will be adversely affected thereby in comparison with others. It is generally recognised that in imposing a new tax, or in increasing an old one, this should not be done so as to place an undue burden on any one class or community. From this point of view profits derived from coinage and from the issue of paper currency are peculiarly free from objections because, when regarded as a substitute for a tax, the slight burden they cause is more evenly distributed over the whole population than any tax possibly could be.

In the controversy which raged for several weeks after the publication of the Report of the Indian Currency Committee (1919) there were not wanting speakers at public meetings and correspondents of newspapers who asserted that the Committee's policy was deliberately conceived in the interests of British financiers. These gentlemen merely revealed their ignorance of the Committee's proceedings. Any one who reads the Report, and studies particularly the

questions put to witnesses and their answers, which are printed verbatim in the volume of Minutes of Evidence, must be convinced that the Committee, whatever the value of its report, had solely the future interests and welfare of India as the object of its deliberations and recommendations.

Our attention may now be turned to a fallacy which is very widely held and was continually asserted as an almost self-evident truth in the controversy following the adoption by the Government of the policy of a high exchange. It was asserted that the fixing of a high rate of exchange would permanently affect the Indian export trade, and that not only the merchants, but the multitude of ryots—the poor producers of cotton, jute, hides and so forth—would bear the burden of the Government's policy. Furthermore, it was asserted that the high exchange would tend to destroy Indian industries—at any rate, that it would delay and retard their growth because of the competition arsing from the importation of foreign goods at lower prices. These fallacious arguments are very plausible ; and they carry conviction to thousands simply because there is some truth in them when applied to a period during which exchange continues *rising*. They are not true, however, when exchange remains stationary at a high level.

The question whether the fixing of a high rate of exchange is permanently prejudicial to Indian interests or trade is, however, one which involves economic theory ; and without a comprehension of

underlying economic tendencies, the correct view will not be reached. A study of the evidence submitted to the Currency Committee, and of their questions, makes it quite clear that the opinion of the Committee was that, although the actual rise of the rate of exchange from a low to a higher figure must undoubtedly cause considerable economic disturbance and be therefore for a time prejudicial, particularly to the export trade, the effect would not be permanent. They anticipated that a new equilibrium of prices in India and in foreign markets would come about, and that the future growth of Indian trade and industries would adapt itself to this new price level. The net effect would be that Indian industries and trade would, after recovering from the difficulties of the transition, prosper just as much at a high rate of exchange as at a low rate. Unfortunately the Committee, whilst evidently holding this view, did not give a clear explanation of it—indeed they scarcely attempted to do so. It is of interest, therefore, and of some importance as a basis of a correct judgment of exchange policy, to attempt an explanation of the reasons why the Committee's views undoubtedly are correct.

The effect of a high exchange upon trade and industries can become clear only if we consider the relation which usually prevails between the level of prices in general and the exchange rate. In normal times, as before the war, there existed between every country a balance as between the level of prices in

that country and the world's market in general For example, India had prices at a certain level, the exchange rate stood at 1*s.* 4*d.*, and the prices in the world's markets were at a certain level. At these levels of prices, certain commodities were cheaper in India than outside and were exported, whilst other commodities were cheaper in other countries than here and were imported into India. It may be said that in international trade prices within the country are balanced against prices outside the country through the rate of exchange. There are three things capable of varying : (1) prices outside the country ; (2) the rate of exchange ; and (3) prices within the country. If any one of these three factors be changed and one remain unaltered, then the third one must change to balance the alteration of the first. Thus, if, during the years before the war, exchange had been arbitrarily put up, say, to 1*s.* 8*d.*, prices in the world's markets would have remained much the same, and the general level of prices in India would necessarily have fallen. Again, if prices outside India had risen very rapidly, and the exchange rate had remained unaltered, then Indian prices would have had to rise also to restore the balance. That is, in fact, what actually did occur during the first three years of the war.

Since August, 1917, however, when the price of silver compelled Government to raise the exchange rate, the equilibrium was partly re-established by means of the higher exchange level. The rise of prices in 1914-1917 was always following the rise

of prices in Europe and the world's markets, but it was lagging behind, the rise occurring more slowly, because the expansion of the currency in India was slow to affect the vast area of inland trade. As Indian prices lagged behind, it meant that the raising of the exchange rate in recent years had the effect, not so much of reducing prices in India, as of stopping the further rise which would have gone on in response to the continually rising world prices.

The ground is now clear for us to examine the results of the rise of exchange ; and these may be compared with what would have happened if exchange had not been raised. We may consider first of all the transient or temporary effects and afterwards the permanent results. The first effect of a rise in the exchange rate is to stimulate imports, and at the same time to check exports. The importer finds his rupee will buy more of the foreign monies than before, so imports are cheapened in terms of rupees. On the other hand, the exporter commonly sells his goods at prices fixed in pounds sterling, or in dollars. Whilst exchange is actually rising, he loses on individual transactions (except in so far as he can cover his sales by opposite transactions), because he realises payment some time after having made his purchase of goods for sale, and finds his sterling bill worth so much less in rupees. The rise of the exchange rate also affects sales, because the exporter is obliged to sell at the market price in the world's markets, and this price, when translated into rupees at a higher exchange

rate, means a greatly reduced profit, or even a loss. The result is that the rise of the exchange rate depresses the prices of commodities of export, excepting only those for which India has an almost complete monopoly of supply.

In the case of jute, lac, and other commodities, of which India is practically the only important producer in the world, the prices in the world's markets are bound to rise in response to the rise of the rate of exchange. They did in fact do so in 1919, the rise of the price of lac during the later months of that year having been directly due to the rise of the Indian exchange. In the case of a number of commodities of which India supplies a considerable part of the world's supply, the rise of exchange has the effect of withdrawing from the world's markets such part of the Indian supply as was available only at comparatively high prices ; and thus it has a partial effect in raising the world's prices. In the case of such commodities as hides, tea, rice, sandalwood, and a number of others, the world cannot get on for long without using India's supply, and thus, as European and American stocks become partly exhausted, the world price must rise sufficiently to draw from India the greater part of her former supply. On the other hand, in the case of commodities of which India supplies but a small part of the world's total supply, the price in the world's markets will not respond to the rise of the Indian exchange, and the supply of these commodities from India may cease altogether, or can only be continued at a lower cost of production

—in other words, wages and profits must fall, or cheaper means of producing the commodity must be found, as by introducing improved methods or machinery.

Thus we have three classes of commodities : (1) Those in which India has a monopoly, and the price rises in the world's markets to a degree equivalent to the rise of exchange ; (2) those in which India has a partial monopoly, and there is a rise of price in the world's markets sufficient to compensate partially for the rise of exchange ; and (3) those in which there is no monopoly and no resulting rise in the world's market price, so that until the cost of production in India is reduced, its export trade in these commodities must be greatly reduced. The foregoing are the temporary and immediate effects of the higher exchange on the export trade and industries. The permanent effects will be examined later in this chapter.

In the case of the import trade, a rise of the exchange rate must at first prove embarrassing to certain Indian industries which make goods in competition with foreign supply ; for example, factories making soap and glass and iron and steel goods should theoretically find the competition of imported goods more severe after the rise of exchange. In actual fact, not much trouble was experienced in India from this cause during the period of high exchange in 1919 and 1920, because prices in most of the world's great industrial countries were rising concurrently with the rise of exchange, so the rise of

exchange did little more than keep the prices of many imported goods stationary, and the Indian producer had still a considerable margin of profit. When world prices started falling in the summer of 1920, exchange was already on the downgrade.

Permanent Effects of Higher Exchange

The effects of the rise of exchange as just explained, are fairly well understood by the commercial community. In actual fact the very heavy adverse balance of trade during 1920 and 1921 has led to the fall of exchange to a figure lower than that corresponding with the old rating of Rs. 15 to £1. This has delayed the realization of the new currency system established by the legislation of 1920, the object of which was to fix exchange permanently at 2*s*. It may be supposed, however, that the adverse balance of trade will work itself out before the end of 1923, and that, if there be no reversal of the Government's policy within that period, exchange will gradually rise, with fluctuations. The rapidity and extent of the rise of exchange will depend upon many factors, including the revival of demand and the course of prices in foreign markets. An equally important factor, however, will be the internal level of prices ; and this will depend on the one hand on the activity of trade in India which depends on the monsoon, and, on the other hand, on the volume of the rupee circulation. The latter is a more important factor than is generally realized, and falls naturally into two divisions : the total net issue of paper currency, and the quantity of silver

rupees in circulation. If these two taken together are diminishing quantities relatively to the volume of trade which has to be financed prices tend to fall and the export trade increases relatively to the import trade.

Assuming that the present policy is maintained, that the paper currency circulation is further diminished, not merely by the encashment of notes, but by reducing the notes outstanding against securities, the limitation of the total volume of currency must ultimately have a predominating effect upon exchange. By the expedient of contracting the rupee circulation Government could in course of time force the exchange up to any level desired.

It is not a discussion of the "impossible" or even the "unlikely," therefore, if we proceed to assume that Government might yet realize its declared policy of raising exchange to 2*s.* and maintaining it permanently at that level. It is worth while fully to consider what would be the economic effect of this policy, and whether, as is feared in some circles, a permanently high exchange would have a prejudicial effect upon India's commercial and industrial future. We have already examined the transitory effects produced by a rise in the exchange rate. These are of the nature of what economists call "short-period effects." When the exchange rate has been altered and it stands permanently at a higher level, many economic re-adjustments take place which eliminate the transitory profits and losses which are characteristic of a period during

which exchange is rising. The permanent effects of a rise in exchange are somewhat obscure, and can only clearly be understood by comparing the situation resulting from the higher exchange with the state of things which would have prevailed if exchange had remained fixed at a lower level.

Let us assume that exchange remains fixed for several years at 1*s.* 4*d.*, and is then rapidly raised to 2*s.* and maintained at that level. When exchange is at 1*s.* 4*d.* importers and exporters adjust their trade to that rate of exchange. The importer calculates whether when he has to pay Rs. 15 per £1, or Rs. 3 for one dollar (on gold basis), it is profitable for him to import at the price quoted in England or America. If he sees a good profit he buys ; and the competition of importers doing the same brings down the price of the imported article in India to a level which corresponds with the price in England or America multiplied by the rate of exchange in terms of rupees.

The exporter makes similar calculations. He ascertains the lowest price at which he can purchase the goods in India, converts into foreign currency at the prevailing rate of exchange, and makes his offer to the foreign buyer on this basis. If the Indian price thus converted is low he will make a big profit ; and many other exporters will soon come into the business and raise the price of the goods in India and lower the price in the foreign markets in which they are being sold.

In this way the prices of both imported and

exported goods in India become equated with the foreign prices multiplied by the rate of exchange. Let us assume now that the rate of exchange is gradually raised to 2*s.* and thereafter is permanently maintained at that level. As we have already seen *during the change* some persons will profit and other persons will lose, according to the nature of the stocks of goods which they hold and their contracts and commitments. When these transitory effects have worked themselves out the net result will be that prices in India will have readjusted themselves to the new level of exchange. Importers will still calculate in the same way, and will find that they can make a profit at a lower selling price. Competition of importers will therefore bring down the price in India in the same proportion as exchange was raised. Exporters will find that they cannot make a profit if they export goods bought in India at the prevailing level of prices. The export trade languishes, therefore, until the price of the Indian goods has fallen in India and risen in foreign markets sufficiently to counterbalance the new ratio of exchange.

The effect of the high exchange is to reduce the prices in India, both of goods imported and goods exported. But practically all goods may be either imported or exported. If the price of any kind of article does not fall when exchange is raised, that kind of article, or substitutes for it can be imported at a profit and thus its price will be forced down.

It is clear therefore that when the higher level of

exchange is established and maintained unaltered, a reduction of the general level of prices in India must take place by a corresponding proportion. There is, in fact, an inexorable equation which must be satisfied. If P means price in foreign countries and p the price in India, and e the rate of exchange, then it must always be true in the long run that :

$$P \times e = p.$$

This equation must be satisfied after the period which is necessary for the various economic adjustments to take place—say, two or three years.

The meaning of the equation will be perfectly clear when it is expressed in figures. If we denote the price-level in foreign countries by 100 and in India by 1,500 when exchange is 1*s.* 4*d.*, we may write—

$$100 \times \text{Rs. } 15 = \text{Rs. } 1{,}500.$$

and, the new level of prices resulting from the raising of exchange to 2*s.* will be represented thus—

$$100 \times \text{Rs. } 10 = \text{Rs. } 1{,}000.$$

In other words the price-level in India will have fallen in the proportion of 150 to 100, or to two-thirds of its former level.

It may be said that this is quite a simple equation; but that it does not prove that Indian trade and industries will not be injured by the permanently high level of exchange. No obvious proof can be given to a person who is not acquainted with the economic causes which determine prices. The price which tends to be established in any market is such as will call forth from the sources of supply

such a quantity per annum as will be absorbed by the demand at that price. Various parts of the total supply are produced at differing costs of production ; also the quantity demanded becomes large the lower the price. Hence, there must be some point at which the two balance ; and this price will actually become established unless disturbing factors intervene. The establishment of a lower level of prices in India will gradually extend to all kinds of goods and services. Wages will be lower ; and even rents of land and houses, unless other economic forces, such as growth of population, override the general effect of exchange. With trifling exceptions due to local or special causes the costs of production of all goods will fall in the same proportion as the general price-level. Thus, the full volume of the annual supply of the commodity will be maintained at the lower price, and the profits will bear the same proportion to the price as at the former higher price-level. When all the economic adjustments have come about the *relative* prices of all goods and services will be the same as they were at the higher price-level. All that will have happened will be that the purchasing power of the rupee in terms of quantity of commodity purchased will be increased in the same ratio that exchange is raised. Whereas now the rupee will buy only 2 yards of Indian-made cotton cloth of a certain quality, it will then, with exchange at 2*s.*, buy 3 yards of the same quality owing to the lower price level in India ; and the price of wheat will, on the

average of good and bad seasons, change from six seers to nine seers for the rupee. When exchange is permanently high all work and trade will proceed as profitably as if exchange were low, the only difference being a lower level of prices in general. We may remember the formula : *High exchange, low prices* ; *low exchange, high prices.*

The process of readjustment cannot, however, be equally smooth in all industries. Earlier in this chapter we distinguished different classes of industries ; and we may enquire briefly how the economic readjustments, resulting from fixing and maintaining a high rate of exchange, will affect each class. The " national monopoly " industries, such as jute and lac, were, as we saw above, able to protect themselves by obtaining a corresponding rise in the world's market prices ; but this will be a temporary rise of price only, because with the lower general level of prices in India, the cost of production in these industries will gradually fall. There is no real monopoly, because the multitude of producers of both jute and lac do not combine to maintain prices. By competition amongst themselves, their sale price will be reduced to the cost of production ; and this latter will fall to a level corresponding with the rate of remuneration prevailing for people of the same standard of living and having a similar degree of skill in other occupations. The cost of production, indeed, is bound to find its own level. The only obstacle to its falling would be found where rents of agricultural land were formerly below the

economic level and, having been raised, it would be difficult to get them down again. However, cultivators of jute, cotton and similar export commodities, have probably not been prospering long enough for rents to be permanently raised.

The industries of class (2), producing goods in which India has a partial monopoly, or a large share of the world's supply, will be affected in a similar manner to the above described "national" industries; and their cost of production will also settle down to the new general level of prices. The third class of industries, those in which India has no monopoly, will gradually recover their places in the world's markets, as there will be a corresponding fall of the cost of production in those industries. The general economic law of international trade, called in its old fashioned statement "the doctrine of comparative costs", comes into effect. Prices and costs of production must readjust themselves, so that the commodities which India can produce comparatively more cheaply than other commodities will take their place in the export trade of the country. This is true in the case of every commodity up to a certain limit for its volume of production in the country—or up to a certain "margin," as economists say, which is determined by the law of diminishing returns.

The net result is that, after the period of readjustment, which may take from three to five years to complete itself, all the industries will be in the same relative position to one another as before the rise

of the rate of exchange. This will undoubtedly be the general result, the only difference which may remain being the above mentioned case of rents, and such improved methods of production as may have been introduced into industries in the meantime, perhaps as the result of the need of more economical methods of production when the pressure of falling prices began. A further qualification is necessary if the above statements are to be scientifically accurate. Wherever in the foregoing paragraphs a fall of the level of prices or a lower cost of production is mentioned, it should be understood that world prices are considered to be stationary. It is only a *relative* reduction of prices and costs which is referred to, and such a relative reduction would take place if world prices continued rising, whilst prices and costs in India remained stationary. On the other hand, if world prices are falling, a *relative* reduction means a more rapid fall in India.

Looking back over the foregoing arguments, we see that the general result of establishing exchange at a permanently higher level will be to give the rupee as the monetary unit a greater purchasing power than it would have had if exchange had not been raised ; but its relative purchasing power as between different commodities will remain unchanged. Hence, the net result of the permanently higher exchange level is simply to cause an appreciation of the currency. The transition period is, of course, uncomfortable for all persons engaged in foreign trade, and particularly for those producing for

export ; but when the transition is passed through they will be in the same position as they were before the change began. Those classes and persons may suffer loss and inconvenience during the inevitable period of transition, but they made great profits during the war before exchange was raised.

In the foregoing arguments it has been assumed that exchange could be forcibly raised and maintained. This, however, is an economic fiction, as Government learnt to its heavy cost in 1920. It is not strictly accurate to regard the exchange rate as capable of being varied at will, and to assert that the price-level must change in India in corresponding proportion. The price-level may indeed prove obstinate and refuse to come down. In that case it would be impossible to maintain the high rate of exchange.

In actual fact it will probably be necessary for Government to take action in regard to both variables—the rate of exchange and the total volume of the rupee circulation. The contraction of the circulation must tend to bring down prices in India and that will tend automatically to raise exchange. Artificially raising the rate of exchange by the sale of Reverse Councils tends to reduce the circulation in India, *if* the currency notes paid for the Reverse Councils be cancelled, or if rupees or gold be withdrawn from circulation or from the Paper Currency Reserve by the transference of funds of the Gold Standard Reserve to India. In those ways both results will be brought about at the same time,

namely, a higher rate of exchange and a lower price-level in India. This is the only way in which the policy of a permanent 2*s.* exchange could be brought into operation.

There are many economic truths which are clear as daylight to economists practised in the study of the theories of exchange and prices, but which are very difficult to explain clearly to the popular reader. It is to be hoped, however, that anyone who has carefully followed the reasoning of the foregoing pages will be convinced that once the rate of exchange had been raised as just described, and all the economic readjustments had come about, no permanent economic burden would be laid upon India thereby. Stated briefly there would be fewer rupees in circulation, and each would buy more than it did before. Indian capital would be worth fifty per cent more in repayment of foreign debts and when invested abroad ; and the currency system would have the advantage of being more adequately protected against disturbance by the rise of the price of silver.

Appendix I.

THE PRICE OF BAR SILVER IN LONDON.

Year.	Average annual price of Silver in London per ounce.	Year.	Average annual price of Silver in London per ounce.	Year.	Average annual price of Silver in London per ounce.
	Pence.		Pence.		Pence.
1845	59¼	1861	60 13/16	1877	54 13/16
1846	59 5/16	1862	61 7/16	1878	52½
1847	59 11/16	1863	61⅜	1879	51½
1848	59⅜	1864	61⅜	1880	52¼
1849	59¾	1865	61 1/16	1881	51⅝
1850	61 1/16	1866	61⅛	1882	51 1/16
1851	61	1867	60 9/16	1883	50 9/16
1852	60½	1868	60½	1884	50 11/16
1853	61½	1869	60 7/16	1885	48 9/16
1854	61½	1870	60 9/16	1886	45⅝
1855	61 5/16	1871	60½	1887	44 11/16
1856	61 5/16	1872	60 5/16	1888	42⅞
1857	61¾	1873	59 3/16	1889	42 1/16
1858	61 5/16	1874	58 5/16	1890	47¼
1859	62 1/16	1875	56 1/16	1891	45 1/16
1860	61 11/16	1876	53⅛	1892	39½

APPENDIX I—*contd.*

Year.	Average annual price of Silver in London per ounce.	Year.	Average annual price of Silver in London per ounce.	Year.	Average annual price of Silver in London per ounce.
	Pence.		Pence.		Pence.
1893	$35\frac{9}{16}$	1903	$24\frac{3}{4}$	1913	$27\frac{9}{16}$
1894	$28\frac{15}{16}$	1904	$26\frac{13}{32}$	1914	$25\frac{1}{8}$
1895	$29\frac{13}{16}$	1905	$27\frac{21}{32}$	1915	$23\frac{21}{32}$
1896	$30\frac{3}{4}$	1906	$30\frac{7}{8}$	1916	$31\frac{1}{4}$
1897	$27\frac{9}{16}$	1907	$30\frac{3}{16}$	1917	$40\frac{7}{8}$
1898	$26\frac{15}{16}$	1908	$24\frac{13}{32}$	1918	$47\frac{1}{2}$
1899	$27\frac{7}{16}$	1909	$23\frac{23}{32}$	1919	57
1900	$28\frac{5}{16}$	1910	$24\frac{21}{32}$	1920	$61\frac{1}{2}$
1901	$27\frac{3}{16}$	1911	$24\frac{19}{32}$	1921	$36\frac{1}{2}$
1902	$24\frac{1}{16}$	1912	$28\frac{1}{16}$		

Appendix II.

FORMS OF HUNDIS.

There is an ancient customary form in which hundis are drawn, which varies but little in essential wording throughout India. There are "usance" hundis, due after a certain lapse of time, which are usually drawn payable at 60 or 61 days after sight, and "demand" hundis, payable on demand like cheques but drawn by the creditor, and equivalent to "sight bills" of European commerce. The forms of both are full of curious compliments and archaic expressions. An example of each kind is given here, with a literal translation. The statement of half the amount payable is inserted so as to make fraudulent alteration more difficult.

Usance Hundi.

To Sidh Sri Indore maha subh sutank bhai Ala Baksh Madho Lal likhi Ujjain se Ram Bihari Lal ka Ram Ram banchna. Appranch Hundi 1 rupia 2,500 ankre pachis sau jiska nima rupia sarhe bara sau ka duna pura athe rakha. The Bank of Indore Limited pas miti Bhadwa sudi 8 se din 60 sath pichhe name sah jog Hundi chalan kaldar dija miti Bhadwa sudi 8 Samwat 1978.

Literal Translation.

To the most propitious place Indore Messrs. Ala Bakhsh and Madho Lal written from Ujjain Ram Bihari Lal sends greetings. Furthermore one[1] hundi for rupees 2,500 in words twenty-five hundred the half of which is twelve hundred and fifty pay double of this to the Bank of Indore, Limited, from Bhadwa sudi 8 after 60 days in current money with Emperor's head after due inquiry. Bhadwa sudi 8 Samvat 1978.

In this case Ram Bihari Lal of Ujjain is the drawer, Messrs. Ala Baksh and Madho Lal of Indore are the drawees, who owe the money, and the Bank of Indore the payee. The date is given in the Samvat calendar as sudi 8 in the month Bhadwa of the year 1978 of the Samvat era, which is equivalent to the 9th September, 1921. The first date is that from which the hundi is current, and the second the date on which it was drawn, in this case the same. The original bears the drawees' acceptance, the signature being written across.

[1] Meaning "original," not duplicate.

Appendix II—*contd.*

Demand Hundi.

Shri sidh Cawnpore subhasthan shri patri bhai Ram Lal Har Narain jog likhi Pragji se Ram Nath Chandu Lal ki Ram Ram banchna. Age hundi kita ek ap upar kia rupia 500 ankan panch sau ke nime do sau pachas ke dhune pure dena. Yahan rakha bhai Imperial Bank of India, Allahabad vale ke miti katik sudi teras se pahunche dam dhani jog bina jabta rupia bajar chalan hundi ki rit thikane lagaye dam chaukas kar dena. Miti kuar sudi teras Samvat 1978.

Literal Translation.

To the auspicious place Cawnpore this good letter is written from Prayag. To Messrs. Ram Lal, Har Narain, Messrs. Ram Nath, Chandu Lal send greetings. We have drawn on you this one hundi for Rs. 500, in words Rupees Five Hundred, half of which is Rupees Two Hundred and Fifty, the full double of which pay here to Messrs. the Imperial Bank of India of Allahabad, on demand after Kuar Sudi teras which please pay to the known party without commission in the current currency of the place after making careful enquiry. Dated Kuar Sudi teras Samvat 1978.

The phrase "in the current currency of the place" is a relic of the eighteenth and early nineteenth centuries when the direst confusion prevailed in the currency, and rupees of different weights, and other coins, were current in different parts of India.

Appendix III.

Statement of the Affairs of the Imperial Bank of India on the 30th December, 1921.

LIABILITIES.	Rs. 1,000's.	ASSETS.	Rs. 1,000's.
Subscribed Capital ...	11,23,96	Government Securities ...	11,12,16
Capital paid up... ...	5,62,24	Other authorized securities under the Act	1,32,59
Reserve	3,91,79	Loans	18,67,43
Public Deposits ...	6,79,99	Cash Credits	25,25,83
Other Deposits... ...	64,90,62	Inland bills discounted and purchased	10,28,38
Loans against securities per contra	39,91	Foreign bills discounted and purchased	2,01
Contingent liabilities ...	...	Bullion	9
Sundries	1,89,45	Dead Stock	2,38,93
		Liability of constituents for contingent liabilities per contra	...
		Sundries	81,73
		Balances with other banks ...	10,01
			69,98,16
		Cash	13,55,84
Rupees ...	83,54,00	Rupees ...	83,54,00

The above balance sheet includes—

	£	s.	d.
Deposits in London	43,400	8	0
Advances in London	344,500	0	0
Cash and balances at other Banks in London	62,194	0	0

N. M. MURRAY, (*Offg.*),
Managing Governor.

Percentage 18·32.
Bank rate 7 per cent.

Appendix III—*contd.*

The weekly statement of the Imperial Bank is a balance sheet; but the corresponding items are named and arranged differently from those of the ordinary bank balance sheet described in Chapter VI (see pages 44 to 59). On the Liabilities side the Reserve fund is merely called "Reserve"; the "Public Deposits" means the deposits of Government and "Other Deposits" those of the public. "Loans against securities *per contra*" represents sums which the Bank has borrowed against some of its "Government securities," or "other authorised securities under the Act," included in the totals on the Assets side. "Sundries" means miscellaneous liabilities.

On the Assets side "Government securities," represent the investments made by the Bank in Government loans. "Other authorized securities under the Act" are the Bank's investments in Municipal, Port Trust, and other loans or debentures which the Bank is authorised to invest in under the Act. "Balances with other Banks" are balances of the accounts opened with other Banks to facilitate collection and payment of cheques, etc., (see page 89). "Bullion" is the amount of Gold and/or Silver held by the Bank. "Cash" represents the balance of cash in hand. These five items taken together would constitute the "Reserve" of an ordinary commercial bank as described at the bottom of page 48; but for a central bank, such as the Imperial Bank, the cash reserve is the important item. The figure of percentage stated at the foot, namely, 18·32, is the percentage which the cash (13½ crores) bears to the "outside" liabilities, namely, the deposits, loans and sundries, which total Rs. 74 crores; and it is very carefully watched. The bills discounted and purchased are stated as in the usual bank balance sheet, except for the distinction of foreign from inland bills. The smallness of the amount of foreign bills is due to the restriction in the Act against undertaking exchange business for the public (see page 82). "Dead-stock" means the Bank's premises, furniture and moveable property (other than money and bullion), which are probably taken in at less than its market value; and "Sundries" includes a variety of miscellaneous assets.

APPENDIX IV.

Abstract of Accounts of the Department of Issue of Paper Currency on the 22nd February, 1920.

[*In lakhs of rupees.*]

	TOTAL AMOUNTS OF NOTES IN CIRCULATION.			RESERVE.							
				COIN AND BULLION.					SECURITIES. (PURCHASE PRICE.)		TOTAL.
				In India.			In England.	In transit between India, England and His Majesty's Dominions.			
	In Reserve Treasuries.	Elsewhere.	Total.	Silver Coin.	Gold Coin and Bullion.	Silver Bullion under Coinage.	Gold Coin and Bullion.	Gold Coin and Bullion.	In India.	In England.	
	1	2	3	4	5	6	7	10	14	15	16
Calcutta ...	41	54,56	54,97	7,28	9,25	7,24	2,21	3,50	(a) 15,60	(b) (c) 82,50	1,27,67
Cawnpore ...	...	10,71	10,71	3,20	48	...	...	...	...	...	3,68
Lahore ...	...	12,33	12,33	2,01	1,80	...	...	...	...	...	3,82
Bombay ...	9	47,18	47,26	10,77	27,70	2,67	...	...	...	...	41,14
Karachi ...	...	8,26	8,26	89	22	...	..	...	...	...	1,11
Madras ...	1,47	22,06	23,53	3,22	51	...	...	...	...	...	3,73
Rangoon ...	...	27,07	27,07	1,43	38	...	...	...	...	...	1,81
Total ...	1,97	1,82,16	1,84,13	28,81	40,34	9,91	2,21	3,59	15,60	82,50	1,82,94
Deduct—Withdrawn from circulation by Foreign Circles and in course of remittance to Circles of Issues.			1,19	Deduct dues on T. T.'s drawn by one circle on another.							...
			1,82,94								1,82,94

(a) Nominal value—Rs. 10,20,81,500 of rupee paper and Rs. 5,89,00,000 Indian Treasury Bills.
(b) Nominal value—Rs. 83,78,25,001.
(c) Including Treasury Bills purchased under Section 3, Act XI of 1917, as amended by Act VI of 1918 and Act II of 1919.

Appendix V.

LIST OF BOOKS.

I.—Books relating to India.

(1) *Indian Finance and Banking* by G. Findlay Shirras (Macmillan & Co., Ltd., London). 1919.

(2) *Indian Currency and Finance* by J. M. Keynes (Macmillan & Co., Ltd., London). 1913.

(3) *Indian Currency and Banking Problems* by Tannan and Shah.

(4) *The Future of Exchange and the Indian Currency* by H. S. Jevons (Oxford University Press). 1922.

(5) *Catalogue of the Coins in the Indian Museum*, Calcutta.—

Vol. I by V. A. Smith.

Vol. II by H. N. Wright.

II.—General Books.

(1) *The Mechanism of Exchange* by J. A. Todd. (Oxford University Press). 1917.

(2) *Money* by D. Kinley (The Macmillan & Co., New York). 1913.

(3) *Money and the Mechanism of Exchange* by W. S. Jevons (Kegan Paul & Co.). 1875.

(4) *The Purchasing Power of Money* by Irving Fisher (The Macmillan Company, New York). Revised edition, 1913.

(5) *Money, Exchange and Banking* by H. T. Easton, (Pitman).

(6) *The Meaning of Money* by Hartley Withers (Smith Elder & Co.). 1915.

(7) *A. B. C. of the Foreign Exchanges* by G. Clare (Macmillan). 1911.

(8) *The Foreign Exchanges* by Viscount Goschen (Effingham Wilson, London).

9) *Eastern Exchange, Currency and Finance* by William F. Spalding (Pitman & Sons). 3rd ed.

II.—Currency Committee's Reports.

(1) *Indian Currency Committee, 1893* (Herschell Committee).—

Vol. I Report.

Vol. II Minutes of Evidence with Appendices and Index.

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(2) *Indian Currency Committee, 1898* (Fowler Committee).—

Vol. I Report.

Vol. II Part I Minutes of Evidence.

Part II „ „ „

Vol. III Appendices and Index.

(3) *Royal Commission on Indian Finance and Currency, 1913-14.*—

Part I Report	[Cd. 7068.]
Part II Vol. I Minutes of Evidence . .	[Cd. 7069.]
Vol. II „ „ „ . .	[Cd. 7237.]
Part III Vol. I Appendices . . .	[Cd. 7070.]
Vol. II „	[Cd. 7071.]
Part IV Index	[Cd. 7239.]

(4) *Committee on Indian Exchange and Currency, 1919.*—

Vol. I Report	[Cmd. 527.]
Vol. II Minutes of Evidence . . .	[Cmd. 528.]
Vol. III Appendices	[Cmd. 529.]
Vol. IV Index	[Cmd. 530.]

IV.—Other Government Publications.

(1) *Currency Department Reports* [Reports by the Controller of the Currency] (Annual).

(2) *Mint Reports* for Calcutta and Bombay (Annual).

(3) *Budget* (Annual).

(4) *Selections from Papers Relating to the Introduction of a Gold Currency in India* (Superintendent, Government Printing, Calcutta, 1899).

(5) *Index Numbers of Indian Prices, 1861-1918,* (Department of Statistics) and Annual Supplements.

(6) *Statistical Tables relating to Banks in India* (Annual).

(7) *Statistics of British India* (Annual).—

Vol. I Commercial.

Vol. II Financial.

(8) *Prices and Wages in India* (Annual).

Appendix V—*contd.*

(9) *Accounts relating to the Seaborne Trade and Navigation of British India* (Monthly) [For Statistics of Imports and Exports of Gold and Silver].

V.—Periodicals for Reference.

Indian.

(1) *Capital*, Calcutta (weekly).

(2) *Commerce*, Calcutta (weekly).

(3) *Gazette of India*, Parts I and II (weekly).

(4) *Indian Trade Journal* (weekly).

(5) *Indian Journal of Economics* (monthly statistics at the end).

Foreign.

(6) *Journal of the Royal Statistical Society, London* (4 times yearly).

(7) *Bankers' Magazine*, New York (monthly).

(8) *The Statist*, London (weekly).

(9) *The Economist*, London (weekly).

(10) *Bankers' Magazine*, London (monthly).

(11) *Economic Journal*, issued by the Royal Economic Society, London [Macmillan & Co.] (quarterly).

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